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No. ____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

IN RE EDWARD W.W. HOWELL,
d/b/a HOWELL ELECTRIC COMPANY,
Debtor.

EDWARD W.W. HOWELL,
d/b/a HOWELL ELECTRIC COMPANY,
Petitioner,

v.

THE STATE BOARD OF EQUALIZATION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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September 4, 1984

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QUESTION PRESENTED

1. Whether the legal incidence of the California Sales and Use Tax falls upon the United States in violation of the Supremacy Clause of the United States Constitution, Article VI, Clause 2, when a federal contractor is assessed a use tax on personal property, the legal title to which passed to the United States prior to use by that contractor.

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v.

THE STATE BOARD OF EQUALIZATION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Petitioner Edward W. W. Howell, d/b/a Howell Electric Company ("Howell"), respectfully prays that a writ of certiorari issue to review the judgment and opinion entered by the United States Court of Appeals for the Ninth Circuit on April 19, 1984.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Ninth Circuit (Pet. App. A, pp. 1a-8a *infra*) is reported at 731 F.2d 624. The opinion of the United States District Court for the Northern District of California, as modified by its order of June 17, 1983 (Pet. App. B, pp. 1b-7b *infra*), was not officially

reported. The opinion of the United States Bankruptcy Court, Northern District of California (Pet. App. C, pp. 1c-8c *infra*), was also not officially reported.

JURISDICTION

The judgment of the court of appeals (Pet. App. D, p. 1d *infra*) was entered on April 19, 1984. A timely petition for rehearing and suggestion for rehearing *en banc* was denied by an order dated June 4, 1984 (Pet. App. D, p. 2d *infra*). This Court's jurisdiction to review the judgment below is invoked under 28 U.S.C. § 1254(1) (1982).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Article VI, Clause 2 of the United States Constitution provides:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all treaties made, or which shall be made, under the Authority of the United States, shall be the Supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Section 6006(a) of the California Revenue and Taxation Code,[1] in relevant part, provides:

> **§ 6006. "Sale"**
>
> "Sale" means and includes:
>
> (a) Any transfer of title or possession, exchange or barter, conditional or otherwise, in any manner or by any means whatsoever, of tangible personal property for a consideration. "Transfer of possession," includes only transactions found by the

[1] All statutes referred to are located in *Deering's Annotated California Code*.

board [the California State Board of Equalization] to be in lieu of a transfer of title, exchange, or barter.

* * * *

Section 6007 of the California Revenue and Taxation Code, in relevant part, provides:

§ 6007. "Retail sale": "Sale at retail"

A "retail sale" or "sale at retail" means a sale for any purpose other than resale in the regular course of business in the form of tangible personal property.

* * * *

Section 6007.5 of the California Revenue and Taxation Code provides:

§ 6007.5. Sale of tangible personal property to contractor for use in performance of contracts with United States: Gross receipts included

A sale of tangible personal property to a contractor or subcontractor for use in the performance of contracts with the United States for the construction of improvements on or to real property in this State is a retail sale. The gross receipts from such a sale or the sales price of property so sold shall be included in the measure of the taxes imposed by this part.

Section 6009 of the California Revenue and Taxation Code provides:

§ 6009. "Use"

"Use" includes the exercise of any right or power over tangible personal property incident to the ownership of that property, and also includes the possession of, or the exercise of any right or power over, tangible personal property by a lessee under a lease, except that it does not include the sale of that property in the regular course of business.

Section 6381 of the California Revenue and Taxation Code provides:

> **§ 6381. Sales to the United States or its agencies: Sales to Red Cross**
>
> There are exempted from the computation of the amount of the sales tax the gross receipts from the sale of any tangible personal property to:
>
> (a) The United States, its unincorporated agencies and instrumentalities;
>
> (b) Any incorporated agency or instrumentality of the United States wholly owned by the United States or by a corporation wholly owned by the United States;
>
> (c) The American National Red Cross, its chapters and branches.
>
> This exemption does not extend to the rentals payable under a lease of tangible personal property.

Section 6384 of the California Revenue and Taxation Code provides:

> **§ 6384. Materials purchased for use in performance of contracts with United States**
>
> Notwithstanding any other provision of law the tax imposed under this part shall apply to the gross receipts from the sale of any tangible personal property to contractors purchasing such property either as the agents of the United States or for their own account and subsequent resale to the United States for use in the performance of contracts with the United States for the construction of improvements on or to real property in this State.

STATEMENT OF THE CASE

The decision of the United States Court of Appeals for the Ninth Circuit misapplies this Court's recent decision in *Washington* v. *United States*, 103 S. Ct. 1344 (1983). In particular, the court of appeals [2] badly confuses the issue of whether the California Sales and Use Tax "is discriminatory with regard to the economic burdens that resul[ ]" [3] with the issue that is the principal subject of this action: Whether California, by purporting to levy a use tax on Howell, is in reality imposing a use tax directly on the United States.

California's sales tax is accompanied by a use tax. The use tax is imposed upon the user of tangible personal property at the same rate as the sales tax, but *only* when that use is incident to legal ownership of that property. California's use tax is thus a title-based use tax; it is not—as some other states have—a possessory use tax. *Compare United States* v. *Boyd*, 378 U.S. 39, 40 (1964) (Tennessee's tax "imposes a tax upon contractors using property in the performance of their contracts with others, irrespective of the ownership of the property. . . ."), *with* CAL. REV. & TAX. CODE § 6009 (Deering 1975) (use defined as "exercise of any right or power over tangible personal property incident to the ownership of that property").[4]

The circuit court below held that California can tax the United States, and thus evade the constitutional immunity of the United States from state taxation, by levying a use tax on Howell, a government contractor. As detailed below, legal title to the personal property had vested in the United States prior to use by Howell. Accordingly, Howell had possession but not legal title to personal property used for the improvement of real property owned by the United States.

In reaching its decision, the Ninth Circuit totally confuses this Court's "direct tax" cases with its "discrimination" line of

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[2] Howell v. State Board of Equalization (In re Howell), 731 F.2d 624 (9th Cir. 1984).

[3] Washington v. United States, 103 S. Ct. at 1349.

[4] *See also Prentice-Hall All States Tax Guide* at ¶ 5003 (1977 ed.) ("*Use taxes are imposed on the privilege of ownership or possession*, storage, use or consumption of goods in the state.") (emphasis added).

opinions. The court of appeals also ignores the fundamental distinction between California's sales tax and its complementary use tax, the tax being applied to Howell here. In this regard, the court fails to deal with—or even acknowledge—the holdings of other courts that, when the United States becomes the owner of personal property under a title-based use tax like California's, the Supremacy Clause of the United States Constitution precludes application of the use tax to a government contractor.

1. The California Sales And Use Tax Scheme

California is one of many states that have a complementary sales and use tax system. Sales and use taxes can be either vendor or vendee taxes. A vendor type tax means that the seller is required to pay the tax to the state; a vendee type tax means that, although the seller is required to pay the tax to the state—just as in the case of vendor type tax—the seller is statutorily entitled to reimbursement of that tax from the buyer.

Although California has characterized its tax as a vendor type tax, this Court has found that, as a matter of federal law, the legal incidence of the tax falls upon the purchaser and not upon the vendor. *See, e.g., Diamond National Corp.* v. *State Board of Equalization,* 425 U.S. 268 (1976) (holding "that the incidence of the [California] state and local sales taxes falls upon the national bank as purchaser and not upon the vendors"); *United States* v. *California State Board of Equalization,* 650 F.2d 1127, 1132 (9th Cir. 1981), *aff'd per curiam,* 456 U.S. 901 (1982) (affirming the Ninth Circuit's holding that "the California sales tax scheme manifests a legislative intent that the lessee pay the sales tax"). *See also United States* v. *State Board of Equalization,* 536 F.2d 294 (9th Cir. 1976) (holding that the legal incidence of the California sales tax falls on the United States as lessee, rather than on the lessor).

The difference between the two types of sales and use taxes becomes critical when sales to the United States are involved. The legal incidence of a vendor type tax falls on the seller and is constitutionally permissible; the legal incidence of a vendee type tax falls on the United States and is not. *See, e.g., United States* v. *State Board of Equalization,* 536 F.2d at 295; *United*

States v. *California State Board of Equalization,* 650 F.2d at 1131-32.

As noted, the California sales and use taxes complement each other. The California sales tax is imposed on the retailer (seller) of personal property measured by a percentage of the gross receipts; the use tax is imposed on the user (normally, the buyer) at the same rate as the sales tax. The use tax applies *unless* the retailer pays the sales tax in connection with the sale of that personal property. Thus, the use tax affords a mechanism for collection from the buyer.

California Revenue and Taxation Code section 6051 [5] imposes a sales tax, computed as a percentage of gross receipts, upon all retailers for the privilege of selling tangible personal property at retail. A sale is defined by section 6006 as: "(a) Any transfer of title or possession . . . of tangible personal property for a consideration" and "(f) A transfer for a consideration of the title or possession of tangible personal property which has been produced, fabricated, or printed to the special order of the customer. . . ."

Section 6007, in turn, defines a retail sale as "a sale for any purpose *other* than resale in the regular course of business. . . ." (emphasis added). Thus, a sale for resale does not constitute a sale for purposes of the California sales tax. And a purchaser can relieve the seller from liability for sales tax by giving the seller a resale certificate indicating that the personal property is to be resold by the purchaser. *See* CAL. REV. & TAX. CODE §§ 6092-6094 (Deering 1975).

There are three sections of the California Revenue and Taxation Code which pertain specifically to United States contractors. Section 6381 exempts from the computation of the tax the gross receipts from the sale of any tangible personal property to the United States. Section 6007.5 defines the sale of tangible personal property to a federal contractor "for the construction of improvements on or to real property" in California as a retail sale. And section 6384 subjects a government

[5] Unless otherwise indicated, all statutory references herein are to the California Revenue and Taxation Code.

contractor to the sales tax regardless of whether the contractor is acting as an agent of the United States or is purchasing the personal property for "subsequent resale to the United States. . . ."

It must be recognized that section 6381, which strictly prohibits taxing the sale of personal property to the United States, is a significant overriding factor in the California taxation scheme. Thus, in order to avoid directly taxing the United States, sections 6007.5 and 6384 move the taxable transaction one step up the chain of sale: These two sections tax the transaction between the supplier and the government contractor as a retail sale. [6] In particular, section 6007.5 purports to tax the supplier irrespective of whether, as with Howell's transactions, the federal contractor issues a resale certificate.

Here, the Board—for unknown reasons—has determined not to follow its own statutes and impose a sales tax on Howell's suppliers under section 6007.5. Under these circumstances, if Howell is to be taxed at all, it must, as clearly recognized by the California State Board of Equalization ("the Board"), [7] be through application of the use tax.

Therefore, as noted above, the California Revenue and Taxation Code provides an alternative basis for taxation: an

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[6] While the statutory authority for its enactment is unclear, Sales and Use Tax Regulation No. 1521 classifies federal contractors as *consumers* of materials and fixtures, but private contractors are treated as *retailers* of materials and fixtures. *See* CAL. ADMIN. CODE tit. 18, R.1521 (1980). However, even though certain professions are specifically deemed "consumers" under the California Revenue and Taxation Code, government contractors are not. *Compare* Washington v. United States, 103 S. Ct. at 1347 n.3 (federal contractors taxed as consumers pursuant to *statute*). Regulation No. 1521 thus appears to be an attempt by the Board to shift the legal incidence of the California tax from the United States to private contractors. Yet such an enlargement of the California tax statutes is strictly prohibited. *See* CAL. GOV'T CODE § 11342.2 (Deering 1982).

[7] Brief of Appellee State Board of Equalization at 3, Howell v. State Board of Equalization (In re Howell), 731 F.2d 624 (9th Cir. 1984) ("The asserted deficiency relates to use taxes alleged to be due on the items so purchased."). *See also* Stipulation Of Facts at ¶¶ 1, 9 (filed with the United States Bankruptcy Court, Northern District of California, August 20, 1980) ("Stipulation Of Facts at ¶ ___"). The Stipulation Of Facts, and the exhibits thereto, are included in the record below.

excise use tax on property purchased for a purpose *other* than resale in the regular course of business. Specifically, section 6201 imposes an excise tax "on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer. . . ." And under section 6202, every person "storing, using, or otherwise consuming in this State tangible personal property purchased from a retailer is liable" for the use tax.

Section 6008 defines storage as including the "keeping or retention in this State for any purpose *except sale in the regular course of business* . . . of tangible personal property purchased from a retailer." (emphasis added). Use of personal property is defined by section 6009 as including "the exercise of any right or power over tangible personal property *incident to the ownership* of that property . . . except that it does *not include the sale of that property in the regular course of business.*" (emphasis added). No definition of consumption is provided within the statutory scheme.

The legally-questionable application of the use tax arises in situations where, as here, the federal government is the recipient of legal title to property—either under the terms of a government contract or by California law—and any use of the property by the contractor in performing that contract is made strictly on behalf of the United States.

In this regard, it is well settled in California that, in order for the use tax to apply, whatever use (including storage) is made of the personal property must occur while the purchaser is the owner of legal title. This is because taxable use, by definition, is that use "incident . . . to ownership. *See* CAL. REV. & TAX. CODE § 6009 (Deering 1975). This basic principle is fully consistent with decisions of California courts interpreting the application of California's use tax. *See, e.g., Lockheed Aircraft Corp.* v. *State Board of Equalization,* 81 Cal. App.3d 257, 272, 146 Cal. Rptr. 283, 292 (1978) ("whatever use (including storage) is made of the property must occur while the purchaser is owner since the taxable use is incident to ownership"). *Union Oil Co.* v. *State Board of Equalization,* 34 Cal. Rptr. 872, 876, 386 P.2d 496, 500 (1963) (holding that use

tax could properly be imposed on lessor of personal property since leasing personal property is incident to the ownership of that property). *See also Levine* v. *State Board of Equalization,* 142 Cal. App.2d 760, 766, 299 P.2d 738, 744 (1956); *General Electric Co.* v. *State Board of Equalization,* 111 Cal. App.2d 180, 184, 244 P.2d 427, 429 (1952).

2. Howell's Contracts With The United States

Howell is an electrical contractor who performs a substantial portion of its business for agencies of the United States Government. In this connection, Howell operates as both a prime and a subcontractor for the improvement of real property belonging to the United States. With respect to the contracts at issue here, Howell acted as a subcontractor on thirteen projects and as a prime contractor on two projects. Stipulation Of Facts at ¶ 4.

In performing these contracts, Howell purchased tangible personal property from suppliers tax-free ("ex tax")—that is, Howell's suppliers did not pay any sales tax. This is because under the California Sales and Use Tax, Howell issued a resale certificate to each supplier, indicating that Howell would be reselling the property to the United States. *See* CAL. REV. & TAX. CODE Tax. Code §§ 6092-6094 (Deering 1975). *See also Stipulation Of Facts at* ¶ 1. As noted above, however, the Board *could* have imposed a sales tax on Howell's suppliers under section 6007.5—despite Howell's issuance of resale certificates.

The Stipulation Of Facts entered into by the parties in the bankruptcy proceeding below describes in detail the contractual provisions for ownership of the tangible personal property involved in each contract, as well as the federal government's complete control over Howell's activities as a contractor. Specifically, the United States acquired title to the personal property installed by Howell at the *earliest* of two dates: (i) pursuant to the contractual provisions,[8] when the Government made its

[8] *See, e.g.,* Stipulation Of Facts at ¶ 15, and Exhibit C. *See also* Contract No. IFB N62474-76-B-7658 at ¶ 7(d) ("Job No. 101"). As noted directly above, all of Howell's contracts with the United States, including Job 101, are referenced in the Stipulation Of Facts.

initial progress payment, or (ii) by law,[9] when Howell first attached the personal property to the Government's real property.

Typically, the general provisions of the government contracts involved herein provide that the United States will make progress payments monthly as work proceeds, or at more frequent intervals. *See* Job No. 101 at ¶ 7(b). And all material and work covered by progress payments immediately becomes the sole property of the United States. *Id.* at ¶ 7(d). *See also* Stipulation Of Facts at Exhibit C.

Regardless of the precise time when title vested in the United States, one point remains clear: Title vested well before use by Howell. Indeed, it should be noted that, with respect to three of the contracts at issue, Howell did not even install the personal property that it had purchased from suppliers. *See* Stipulation Of Facts at ¶ 15. Rather, Howell simply transferred that property to a prime contractor, and the prime contractor installed the materials for the project owner, the United States.

In general, the government contracts also contemplated that the United States would carefully monitor Howell's performance as both a prime and a subcontractor. For example, before Howell could purchase personal property from its suppliers, the United States had to give Howell, or Howell's prime contractor, formal approval. *See, e.g.,* Job No. 101 at ¶ 9. This was to ensure that the materials purchased by Howell fully conformed to U.S. Government specifications. In addition, the federal Contracting Officer had the right to inspect, on a regular basis, all work being performed by Howell. *Id.* at ¶ 10. Finally, as owner of the tangible personal property in Howell's possession, the federal government was of course entitled to remove the equipment at any time during the contract and to direct its further use or sale after completion of the contract. *See generally* Job No. 101 at ¶ 16. In short, the government contracts clearly indicate that the United States regarded itself as the purchaser and owner of all personal property used by Howell.

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[9] *See, e.g.,* General Electric Co. v. State Board of Equalization, 244 P.2d at 430 (title to generator passed when affixed to real property).

Howell's use was merely to accomplish the purpose of the owner: the improvement of property for the Government.

3. Proceedings In The Bankruptcy Court

On February 12, 1979, Howell filed a petition for reorganization under Chapter XI of the Bankruptcy Act of 1978, 11 U.S.C. §§ 1101-1174 (1982).[10] On June 27, 1979, the California State Board of Equalization filed a Proof of Priority Claim for Taxes in the bankruptcy proceeding. The Claim alleged a deficiency under the California Sales and Use Tax Law in the amount of $71,502.34 plus interest for the audit period April 1, 1976 through February 12, 1979. It has never been in dispute that the claimed deficiency concerns *use* taxes assessed on personal property purchased by Howell ex-tax from various suppliers under resale certificates. *See, e.g.,* Stipulation Of Facts at ¶¶ 1, 9.

On April 21, 1980, Howell filed an objection to the Board's Claim and a trial was conducted before the United States Bankruptcy Court, Northern District of California, on August 26, 1980. On September 23, 1981, the Bankruptcy Court entered a Ruling disallowing the Board's claim. *See* Pet. App. C, pp. 1c-8c *infra.* While the Bankruptcy Court disallowed the Board's Claim on the principal ground that California's taxing scheme impermissibly discriminates against government contractors,[11] Howell had also contended that the California tax imposes a direct tax upon the United States in violation of the Supremacy Clause of the United States Constitution. *See* Pet App. A, p. 3a n.1 *infra.*

4. The Decision Of The U.S. District Court

The Board appealed the Bankruptcy Court's Ruling to the

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[10] The United States Bankruptcy Court, Northern District of California, is expected to enter a final order terminating the bankruptcy proceeding in September 1984. After entry of this order, Howell will no longer be conducting its business under Chapter XI.

[11] In reaching its decision, the Bankruptcy Court had relied upon the Ninth Circuit's decision in Washington v. United States, 654 F.2d 570 (9th Cir. 1981)—a decision subsequently overturned by this Court in 1983. *See* 103 S. Ct. at 1344.

U.S. District Court for the Northern District of California. The district court, relying substantially on this Court's recent decision in *Washington* v. *United States,* entered a Memorandum and Order on May 26, 1983.[12] The Order reversed the Bankruptcy Court's Ruling and remanded the case for further proceedings consistent with its opinion. *See* Pet. App. B, p. 6b *infra.*

In its decision, the district court held that the California Sales and Use Tax scheme does not unconstitutionally discriminate between federal and non-federal contractors. Notably, the district court's opinion did not address the issue of whether the California tax impermissibly levies a direct use tax upon the United States.

5. The Decision Of The Court Of Appeals

On April 19, 1984, the U.S. Court of Appeals for the Ninth Circuit affirmed the decision of the district court. Pet. App. A, pp. la-7a *infra.* Howell's petition for rehearing and suggestion for rehearing *en banc* was denied by order dated June 4, 1984. Pet. App. D, p. 2d *infra.*

The court of appeals stated at the outset that the issue presented for review is "the constitutionality of the California Sales and Use Tax as applied to federal contractors . . . ." Pet. App. A, p. 4a *infra.* In this regard, the Court's decision on the merits concentrated on whether California had imposed a direct tax upon the United States Government.[13]

The court based its decision that California had not directly taxed the United States on the sole ground that "the tax is imposed on the transfer of property from a supplier to Howell." Pet. App. A, p. 6a *infra.* But this would seem to describe the imposition of a *sales* tax—not a use tax.

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[12] The decision was modified by Order dated June 17, 1983. Pet. App. B, p. 7b *infra.*

[13] The court of appeals also briefly considered two other issues: (i) whether the Board had statutory authority under the California Revenue and Taxation Code to treat federal contractors as consumers of materials and fixtures, and (ii) whether the Board had a rational basis for distinguishing between U.S. contractors who make improvements to real property and those who simply transfer personal property to the United States without attaching it to realty. Neither of these issues is the subject of this Petition.

In reaching this result, the Ninth Circuit did not address how the Board could levy a use tax on Howell under circumstances where the United States owned the personal property at issue, and where the use of that property could only have been on behalf of the United States. The court's holding, as well as every intermediate step in the court's analysis, followed directly from its initial premise that:

> The Supreme Court implicitly approved the constitutionality of a federal contractor "passing on" the tax to the United States in the reasoning in *Washington* ... . and has expressly upheld its constitutionality in many cases.

Id. at p. 5a *infra* (citation omitted). The court of appeals' opinion thus clearly permits California to levy a use tax on federal contractors—even in circumstances where, as here, the contractor did not have legal title to the personal property and, by definition, any use of property of the United States was exclusively on behalf of the United States.

REASONS FOR GRANTING THE WRIT

This case provides unique and compelling circumstances that necessitate the exercise of the Court's jurisdiction.

First, the court of appeals totally failed to recognize that, as a result of the operation of California's title-based use tax statutes, the legal incidence of the tax falls directly upon the United States as the purchaser and *owner* of the personal property at issue—not upon Howell, the government contractor. In this connection, the Ninth Circuit mistakenly relies on certain decisions of this Court regarding the taxation of federal contractors in states where possessory use taxes, as opposed to title-based use taxes, were in effect. This distinction is critical since it is constitutionally permissible to assess a possessory use tax on a federal contractor. However, it is unconstitutional for California to levy a title-based use tax with respect to personal property that belongs to the United States. It is, of course, so well settled as to be hornbook law that, when the legal incidence of a tax falls upon the United States, that tax

violates the United States' constitutional immunity from state taxation. *See* U.S. CONST. art. VI, cl. 2. Yet, when faced with California's attempt to slide by that basic principle of constitutional law, the court of appeals dismissed that rule with the airy conclusion that the tax could not be upon the United States because "the tax is imposed [by California] on the transfer of property from a supplier to Howell." *See* Pet. App. A, p. 6a *infra*. In reaching this conclusion, the Ninth Circuit completely misunderstands the transaction being taxed. It apparently believed that a *sales* tax was imposed on the sale of personal property from suppliers to Howell. However, even the Board acknowledges that it did not follow California's own statutory scheme by levying a sales tax on Howell's suppliers. Instead, the Board is attempting to impose a use tax on property owned by the United States. Such an application of California's use tax is a tax on the Government itself.

Second, the Ninth Circuit's decision is directly inconsistent with an earlier decision by that same court. Moreover, the court's decision in *Howell* undercuts a decision by the U.S. Court of Appeals for the First Circuit. As a result of the conflict of opinions within the Ninth Circuit, as well as between the Ninth and First Circuits, there is immediate confusion and chaos. Federal contractors are now uncertain as to whether a use tax can be applied to personal property purchased from a supplier for resale to the United States—even in circumstances where the federal contractor has no legal title to the property and the United States has the sole right to direct the use and disposition of that property.

Third, this is not a situation where application of the California Sales and Use Tax to federal contractors controls only a single case. Ordinarily, this Court is justifiably reluctant to consider and determine the validity of a state tax issue as to which the federal courts cannot always have the last word. The court of appeals' decision in this case, however, will not just affect this lawsuit, but will directly control the manner in which thousands of federal contractors are able to allocate costs and bid for, as well as perform, government contracts in states that have title-based use taxes.

1. Under California's Tax Scheme, The Board's Taxation Of Government-Owned Property In Howell's Possession Is A Direct Tax On The United States.

In reaching its decision, the Ninth Circuit completely disregards the simple fact that ownership of the personal property at issue had vested in the federal government. Ownership vested in two ways: Pursuant to government contract,[14] title passed at the time of the initial progress payment; pursuant to California law, title passed when the personal property was first affixed to the real property. *See, e.g., General Electric Co.* v. *State Board of Equalization,* 244 P.2d at 430.

Any attempt by the Board to tax Howell's possessory interest in personal property—property purchased pursuant to government contracts and for no purpose other than immediate resale to the United States—would require legislative action changing the entire nature of the California Sales and Use Tax. Without such action, the legal incidence of California's use tax on personal property in Howell's possession can only fall upon the United States.

California has simply not drawn its tax statutes and regulations so as to reach the materials and supplies being taxed here without transcending constitutional limits. It is emphasized that Howell's action herein does not in any way challenge California's legal power to revise its use tax in order to impose a possessory use tax on materials used by a federal contractor, but owned by the United States. It does not seek to thwart California's authority to impose a tax on a government contractor, even if that contractor has the ability to pass on the tax to the United States. *See Washington v. United States,* 103 S. Ct. at 1347-48; *United States* v. *New Mexico,* 455 U.S. 720, 734 (1982). It does not attempt to contest California's right to implement a complementary tax system under which a tax is to be collected from a government contractor because the party normally taxed (the United States) is constitutionally immune from such taxation. *See* 455 U.S. at 737-38. Rather, Howell merely seeks a ruling that it cannot be held liable for a use tax

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[14] *See* pp. 10-11 *supra.*

in California when the taxable use incident to ownership is in the hands of the United States. It is that simple.

This Court's decisions, as well as decisions of other federal and state courts, strongly support Howell's position. Consideration of this Court's opinions properly starts with the proposition that—in determining who a state intends will pay the tax—the entire state taxation scheme and the context in which it operates, as well as the express words of the taxing statutes, must be considered. *See, e.g., United States* v. *Tax Commission,* 421 U.S. 599, 609-10 & n.8 (1975); *United States* v. *City of Detroit,* 355 U.S. 466, 469 (1958); *United States v. California State Board of Equalization,* 650 F.2d at 1131. And it is well settled that this Court is not bound by a *state's* conclusion as to where the legal incidence of its taxation scheme will fall. *See, e.g., Diamond National Corp.* v. *State Board of Equalization,* 425 U.S. at 268.

It is equally well established that a determination of legal incidence is not only an inquiry into who is legally obligated to remit the collected tax to the state. *E.g., United States* v. *California State Board of Equalization,* 650 F.2d at 1131. Thus, "the legal incidence of a tax does not necessarily fall on the party who acts as a conduit by forwarding collected taxes to the state." *Id.; United States* v. *Tax Commission,* 421 U.S. at 607.

In the last analysis, if the state taxing statute "all but compels" a party who contracts with the United States to collect the tax from the U.S. Government, then such a tax scheme can be said to manifest an intent that the United States directly pay the tax. *United States* v. *California State Board of Equalization,* 650 F.2d at 1132. *See also First Agricultural National Bank* v. *State Tax Commission,* 392 U.S. 339, 347 (1968); *United States* v. *Tax Commission,* 421 U.S. at 608-09.

Inexplicably, the court of appeals does not even acknowledge that the Board is attempting to tax Howell's *use* of the Government's property. This omission is telling; because to permit California to tax Howell for its use of such property—and not just its possessory interest in that property—the court of appeals would have had to ignore the plain terms of the California use tax statute. The Ninth Circuit simply fails to

address the fact that the Board is attempting to accomplish by indirection that which is expressly prohibited by the Supremacy Clause: the taxing of the United States for Howell's use of materials owned by the Government.

To repeat, the stipulated facts below make clear that Howell had no purpose in purchasing personal property from suppliers other than the eventual resale of that property to the federal government. Since, by definition, Howell's business is contracting with the United States, this resale was "in the regular course of business" pursuant to the statutory scheme. *See* CAL. REV. & TAX. CODE § 6007 (Deering 1975). It was for this reason that resale certificates were provided by Howell to its suppliers.

It is equally clear, however, that the Board could have taxed Howell's suppliers under section 6007.5 regardless of Howell's issuance of resale certificates. This is because section 6007.5 provides that a sale of personal property to a federal contractor also constitutes a sale under the California Revenue and Taxation Code. Why the Board determined to ignore that section and impose an illegal use tax on Howell is left a mystery.

Thus, once the personal property was acquired by Howell, it was obviously not used within the meaning of section 6009—wherein "use" is defined as being "incident to the ownership of that property . . . ." Rather, the use was that of the federal government in which title vested, either after the initial progress payment was made by the United States or at the first instant that Howell attached the personal property to the Government's realty.[15] *See, e.g., Lockheed Aircraft Corp.* v. *State Board of Equalization,* 146 Cal. Rptr. at 292; *Union Oil Co.* v. *State Board of Equalization,* 368 P.2d at 496.

Inasmuch as sections 6007.5 and 6384 impose a tax based on ownership of personal property, the Board's attempt to employ these sections to tax federal contractors for using personal property owned by the United States clearly runs afoul of the Supremacy Clause, for it "all but compels" Howell to collect the use tax from the owner of that property, the United States. *See United States* v. *California State Board of Equalization,* 650 F.2d at 1132. And to the extent that section 6384 is

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[15] *See* pp. 10-11 *supra.*

being employed to tax federal contractors for their "use" of Government-owned property—"either as agents of the United States or for their own account"—that section manifests a clear legislative intent that the United States is to pay the use tax. *See id.*

This conclusion is supported by a series of cases from other jurisdictions. In those cases, taxpayer-contractors acquired and retained possession of personal property which was used in performing contracts under which title had vested in the federal government. *United States* v. *Nevada Tax Commission*, 291 F. Supp. 530 (D. Nev. 1968), *aff'd*, 439 F.2d 435 (9th Cir. 1971); *General Motors Corp.* v. *State Commission of Revenue & Taxation*, 182 Kan. 237, 320 P.2d 807, *cert. denied*, 358 U.S. 875 (1958); *State Tax Commission* v. *Graybar Electric Co.*, 86 Ariz. 253, 344 P.2d 1008 (1959); *Avco Manufacturing Corp.* v. *Connelly*, 145 Conn. 161, 140 A.2d 479 (1958).[16] In each case, the state attempted to tax the tangible personal property under a sales and use tax statute similar to California's. Without exception, the courts held that, since the federal government became the owner, neither the sales nor use tax could be applied. Similarly, under the Board's current application of the California Sales and Use Tax, it is clear that the United States is to bear the direct burden of paying that tax.

2. The Court Of Appeals' Decision Conflicts With Other Federal Decisions On The Same Issue.

The court's decision in *Howell* conflicts squarely with another decision of the Ninth Circuit, *United States* v. *Nevada*

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[16] In *Avco*, for example, the Connecticut Supreme Court of Errors distinguished the possessory use tax at issue in Alabama v. King & Boozer, 314 U.S. 1 (1941) from the title-based use tax involved in that proceeding. The court noted that—while the government contract in King & Boozer provided that title to materials purchased by the contractor vested in the United States upon delivery at the work site and inspection by the Contracting Officer—the Alabama statute "placed less emphasis on the transfer of title than does the Connecticut act." 140 A.2d at 485. The Connecticut use tax is like California's; it is based on ownership, not possession.

Tax Commission,[17] and with a decision by the United States Court of Appeals for the First Circuit, *Federal Reserve Bank* v. *Commissioner of Corporations and Taxation,* 520 F.2d 221 (1st Cir. 1975). In both of these cases, the circuit courts considered substantially the same issue and concluded that—in a state with a title-based use tax—the legal incidence of the use tax does not fall upon the government contractor, but directly upon the United States itself.

With respect to the *Nevada* decision, the court of appeals, without elaboration or even citation to that case, broadly states that all of the cases relied upon by Howell were "inapposite" because "[e]ach of those cases involved the taxation of a direct transaction between the United States and some instrumentality." Pet. App. A, p. 6a *infra.* In straining to reach this unwarranted conclusion, the court of appeals was apparently relying on the Board's wholly-erroneous contention that "none of the property in the *Nevada* case was purchased for use in constructing improvements to real property." Brief for Appellee at 11, *Howell* v. *State Board of Equalization (In re Howell),* 731 F.2d 624 (9th Cir. 1984). The Board also argued below that the Nevada tax scheme—at issue in *Nevada*—was different than California's. These are factually-unsupported arguments, offered up by the Board and accepted without question by the Ninth Circuit, but never substantiated or even explained.

In *Nevada,* contrary to the Board's characterization, the state attempted to tax personal property under sales and use tax statutes virtually identical to those in effect in California. *See* Reply Brief for Appellant at A-1—A-2, *Howell* v. *State Board of Equalization (In re Howell),* 731 F.2d 624 (9th Cir. 1984). Moreover, the district court's decision in *Nevada,* affirmed by the Ninth Circuit, directly undercuts the court of appeals' reasoning in *Howell:* that state taxes can only be struck down as direct taxes if they apply to a direct transaction between the federal contractor and the Government. *See* Pet. App. A, pp. 5a-6a *infra.* In particular, the *Nevada* court held that the state could not impose a use tax on a government contractor who

[17] 291 F.Supp. 530 (D. Nev. 1968), aff'd, 439 F.2d 435 (9th Cir. 1971).

purchased personal property from a supplier because title in that property had vested in the contractor's customer, the United States. *See* 291 F. Supp. at 533-37. While the *Nevada* court noted that the state had the legal power to tax such a transaction, *see United States* v. *Boyd,* it concluded that this power had simply not been exercised. 291 F. Supp. at 533-34.

Similarly, the First Circuit in the *Federal Reserve Bank* case was faced with the imposition of a Massachusetts use tax on government contractors who had purchased building materials and supplies for use in the construction of a new Federal Reserve Bank building. Massachusetts, like California, has a title-based use tax. *See* 520 F.2d at 226.

The First Circuit held that the Massachusetts use tax could not be applied because the legal incidence of that tax fell upon the owner of the personal property—the United States—and not upon the government contractors. In this connection, the court emphasized that, while Massachusetts had the constitutional authority to alter its tax scheme to reach the personal property being used, "[t]he tax is not drafted like those in *Boyd* and the Michigan cases so as to avoid the impermissible incidence." *Id.*

The existing conflict in the decisions within the Ninth Circuit, as well as between the Ninth and First Circuits, is already confusing government contractors who conduct business in states with title-based use taxes. This Court's review is appropriate to preclude the disputes among courts and to clarify the manner in which federal contractors should enter into, and perform, government jobs.

3. The Court Of Appeals' Decision Will Directly Control The Manner In Which Thousands Of Federal Contractors Conduct Their Business.

In ruling that California can impose a use tax on a government contractor with respect to tangible personal property owned by the United States, the Ninth Circuit has displaced the established constitutional principle of the U.S. Government's immunity from state taxation. Under the court's opinion, there is nothing to prevent California, and other states with

similar use tax statutes, from imposing such a tax on federal contractors. To tax federal contractors under these circumstances is to tax the United States itself.

It is readily apparent that California's levy of a use tax on Howell will have a widespread and immediate impact on the United States. This is because the situation presented here is not unique: The imposition of a use tax on government contractors who have no title or ownership interest in personal property will compel those contractors to collect the tax from the United States.

Specifically, the United States is the sole entity to whom many federal contractors are likely to be able to sell their products—especially since those products must meet the special requirements of the federal government. *See, e.g.,* pp. 11-12 *supra.* It is typical, then, for federal contractors like Howell to pass on to the United States all costs related to a particular contract since the specialized property is unlikely to have application to other contracts. For this same reason, the federal contractor's investment cannot be spread out over other projects; the United States will have to shoulder the tax burden.

Accordingly, the *Howell* decision will have a serious and unsettling effect on the business of government contracts. It prevents government contractors from properly allocating construction costs. It adds hidden costs to the contractor's services and the Government's contract price. It threatens the predictability of bidding for, entering into, and performing construction contracts for the United States. And the decision makes federal contractors totally dependent on each state's unrestrained attempt to rectify—arbitrarily—the legislative oversight in failing to tax as a "use" a possessory interest in personal property. *See Federal Reserve Bank* v. *Commissioner of Corporations and Taxation,* 520 F.2d at 226.

In sum, any attempt to tax a federal contractor's possessory interest in personal property requires legislation that so provides. Without appropriate legislative action, the legal incidence of a use tax is a direct tax upon the United States in violation of the Supremacy Clause. The *Howell* decision is not limited to California; it will be relied upon to tax the United States in all states that have title-based use tax statutes.

CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be granted.

Respectfully submitted,

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September 4, 1984

APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS,
NINTH CIRCUIT.

In re EDWARD W.W. HOWELL,
d/b/a HOWELL ELECTRIC COMPANY,
Debtor.

EDWARD W.W. HOWELL,
d/b/a HOWELL ELECTRIC COMPANY,
Debtor/Appellant,

v.

THE STATE BOARD OF EQUALIZATION,
Claimant/Appellee.

No. 83-2124.

Argued and Submitted March 13, 1984.

Decided April 19, 1984.

* * * *

Before HUG and FERGUSON, Circuit Judges, and BYRNE*, District Judge.

FERGUSON, Circuit Judge:

On February 12, 1979, Edward W.W. Howell, d/b/a Howell Electric Company ("Howell"), filed a petition for reorganization under Chapter 11 of the Bankruptcy Act, 11 U.S.C. § 1101 *et seq.* On June 22, 1979, the California State Board of Equalization ("Board") filed a priority claim in the proceeding for sales and use tax. The bankruptcy court disallowed the Board's claim, ruling that the California Sales and Use Tax impermissibly discriminated against contractors

*Hon. Wm. Matthew Byrne, Jr., United States District Judge, Central District of California, sitting by designation.

doing business with the United States Government, and thus was unenforceable. The Board appealed this decision to the district court. The district court reversed, finding that no unconstitutional discrimination against federal contractors existed, and Howell appeals. We affirm the district court.

Background

The taxes in dispute are those which the Board claims are due pursuant to Sales and Use Tax Regulation No. 1521, Cal.Admin, Code tit. 18, R. 1521. This regulation governs the taxation of construction contractors. The regulation distinguishes between three types of tangible personal property typically used or installed on a construction project—materials, fixtures, and machinery and equipment. Under the regulation, both United States and private contractors are treated as retailers of machinery and equipment and as consumers of materials. With respect to fixtures, however, the regulation provides for dissimilar treatment of United States and private contractors. United States contractors are classified as consumers of fixtures, and therefore the tax applies to the sale of the fixtures from the supplier to the contractor. Private contractors, on the other hand, are classified as retailers of fixtures; thus, the tax applies to the transfer of fixtures to the project owner rather than to the sale of the fixtures to the contractor. Howell claimed below that this distinction impermissibly discriminates against federal contractors. The bankruptcy court agreed, and additionally ruled that the regulation's taxation of materials also discriminated against federal contractors because nonfederal contractors could reimburse themselves for the tax they were charged on materials by adding the tax to the overall cost passed on to the owner, whereas the federal contractor could not compel the federal government to pay the amount representing the sales tax.

The district court reversed the bankruptcy court's ruling as to the tax on materials, holding that, contrary to the bankruptcy court's conclusion, a federal contractor could constitutionally pass on the materials tax to the United States as part of its overall costs of performance, just as a non-federal contractor could pass on the tax to its project owner, and thus there was no

impermissible discrimination. The district court also reversed the bankruptcy court's ruling as to the tax on fixtures, holding that the California fixtures tax did not place a heavier economic burden on the federal contractor than that borne by a similarly situated nonfederal contractor.

On appeal to this court, Howell advances new grounds to support its contention that the California Sales and Use Tax scheme is unconstitutional: (1) the California tax impermissibly levies a direct tax upon the United States Government;[1] (2) the State Board of Equalization exceeded its statutory authority in adopting a regulation which makes federal contractors "consumers" of tangible personal property that is ultimately resold to the United States; and (3) the California tax impermissibly discriminates between those contractors who sell tangible personal property to the United States in the course of performing construction contracts and those contractors who sell tangible personal property to the United States without installing it.

ANALYSIS

1. *Scope of Review*

The Board contends that Howell has abandoned the position taken before both the bankruptcy court and the district court and, therefore, there are no issues properly presented for appellate review. In most circumstances, a federal appellate court will not consider an issue not passed upon below. *Singleton v. Wulff*, 428 U.S. 106, 120, 96 S.Ct. 2868, 2877, 49 L.Ed.2d 826 (1976); *Helm v. California*, 722 F.2d 507, 510 (9th Cir.1983). However, the rule of waiver is one of discretion rather than jurisdiction, and the Ninth Circuit recognizes an exception under which an appellate court will review an issue not previously raised in the district court. *Telco Leasing, Inc. v. Transwestern Title Co.*, 630 F.2d 691, 693 (9th Cir.1980). The court will consider an issue conceded or neglected below if the

[1] Howell referred to this issue in its pretrial statement before the bankruptcy court, but it was not argued before either the bankruptcy court or the district court.

issue is purely one of law and the pertinent record has been fully developed. *United States v. Patrin,* 575 F.2d 708, 712 (9th Cir.1978). The rule of waiver may also be relaxed when there are significant questions of general impact or when injustice might otherwise result. *Krause v. Sacramento Inn,* 479 F.2d 988, 989 (9th Cir.1973).

The issue presented to us for review—the constitutionality of the California Sales and Use Tax as applied to federal contractors—is a question of law. Additionally, the decisions of both the bankruptcy court and the district court were based primarily on a stipulation of facts between the parties and the pertinent record on the issues raised by Howell is fully developed. We thus exercise our discretion to reach the issues raised by Howell on appeal.

2. *Does the California Sales and Use Tax Levy a Direct Tax upon the United States Government?*

Howell's position before the bankruptcy court and the district court that the California Sales and Use Tax impermissibly discriminated against federal contractors became untenable in light of the Supreme Court's recent decision in *Washington v. United States,* ____ U.S. ____, 103 S.Ct. 1344, 75 L.Ed.2d 364 (1983). In *Washington,* a state statute imposed a sales tax on the sale of materials to federal contractors, but with regard to nonfederal construction projects, the tax was imposed on the project owner. *Id.* at 1347. The United States argued that the statutory scheme discriminated against federal contractors in violation of the Supremacy Clause. *Id.* The Supreme Court rejected the United States' position, holding that the tax was not discriminatory with regard to the economic burdens that resulted, because federal contractors could pass the tax on to the federal government when they set their price. *Id.* at 1348 n. 4. The Court held that it was sufficient that federal contractors had the opportunity to pass on the tax to the United States; it was not required that they actually do so. *Id.* at 1349.

Faced with the result in *Washington*, Howell retreated from the position taken in the lower courts and now claims that the California Sales and Use Tax is unconstitutional because it levies a direct tax upon the United States. This contention, however, has been consistently rejected by the Supreme Court and this circuit. The Supreme Court implicitly approved the constitutionality of a federal contractor "passing on" the tax to the United States in the reasoning of *Washington*, *see* 103 S.Ct. at 1348 n. 4, and has expressly upheld its constitutionality in many cases. *See United States v. New Mexico*, 455 U.S. 720, 734, 102 S.Ct. 1373, 1382, 71 L.Ed.2d 580 (1982) ("immunity may not be conferred simply because the tax has an effect on the United States, or even because the Federal Government shoulders the entire economic burden of the levy. . . . The Government's right to be free from state taxation 'does not spell immunity from paying the added costs, attributable to the taxation of those who furnish supplies to the Government and who have been granted no tax immunity.' ") (quoting *Alabama v. King & Boozer*, 314 U.S. 1, 9, 62 S.Ct. 43, 45, 86 L.Ed. 3 (1941)); *United States v. Boyd*, 378 U.S. 39, 44, 84 S.Ct. 1518, 1521, 12 L.Ed.2d 713 (1964) ("The Constitution . . . does not forbid a tax whose legal incidence is upon a contractor doing business with the United States, even though the economic burden of the tax, by contract or otherwise, is ultimately borne by the United States."). *See also United States v. California State Board of Equalization*, 650 F.2d 1127, 1131 (9th Cir. 1981) ("The constitution only prohibits the state from levying a tax on the United States; it does not prohibit the state from enacting a taxing scheme whose effect is to increase prices paid by the United States."), *aff'd*, 456 U.S. 901, 102 S.Ct. 1744, 72 L.Ed.2d 157 (1982).

The cases cited by Howell [2] to demonstrate instances in which taxes have been struck down as direct taxes on the

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[2] *Diamond National v. State Board of Equalization*, 425 U.S. 268, 96 S.Ct. 1530, 47 L.Ed.2d 780 (1976); *United States v. California State Board of Equalization*, 650 F.2d 1127 (9th Cir. 1981), *aff'd*, 456 U.S. 901, 102 S.Ct. 1744, 72 L.Ed.2d 157 (1982); *United States v. State Board of Equalization*, 536 F.2d 294 (9th Cir. 1976).

United States are inapposite. Each of those cases involved the taxation of a direct transaction between the United States and some instrumentality. In each instance, the court found that the "legal incidence" of the tax fell upon the United States and thus was impermissible. Here, the transaction between Howell and the United States is not taxed at all; the tax is imposed on the transfer of property from a supplier to Howell. Thus, even if Howell is correct in its assertion that the legal incidence of the tax falls on the vendee rather than the vendor in the taxed transaction, the implication of its argument is that the legal incidence falls on Howell rather than on the supplier, *not* that the legal incidence falls on the United States.[3]

3. *Is There Statutory Authorization for Treating Federal Contractors as Consumers of Fixtures?*

Howell contends that Regulation 1521, which classifies federal contractors as consumers of materials and fixtures, is an invalid regulation because there is no statutory authority for classifying a federal contractor as a consumer. We find this argument to be without merit. There are two sections of the California Revenue and Taxation Code which provide for taxation of United States contractors. Section 6007.5 provides:

> A sale of tangible personal property to a contractor or subcontractor for use in the performance of contracts with the United States for the construction of improvements on or to real property in this State is a retail sale. The gross receipts from such a sale or the sales price of property so sold shall be included in the measure of the taxes imposed by this part.

Section 6384 provides:

> Notwithstanding any other provision of law, the tax imposed under this part shall apply to the gross receipts from the sale of any tangible personal property to contractors

[3] Thus, it is not necessary to resolve the issue whether state or federal law governs this determination. The federal cases cited by Howell do not support its contention.

> purchasing such property either as the agents of the United States or for their own account and subsequent resale to the United States for use in the performance of contracts with the United States for the construction of improvements on or to real property in this state.

Thus, whether the sale between a supplier and a federal contractor is one in which the property will first be resold to the United States and then used in the performance of a contract, or first incorporated into the project and then sold as a "package" to the United States, the California statutory scheme taxes the transaction between the supplier and the federal contractor as a retail sale. Therefore, the classification of the federal contractor in Regulation 1521 as a "consumer" in such a retail transaction is not inconsistent with the statute. And, as pointed out by the Board, since the regulation accurately describes the tax consequences of the California Sales and Use Tax, the particular word chosen to describe the contractor is immaterial.

4. *Is There a Rational Basis for Distinguishing Between Contractors Who "Sell" Tangible Personal Property to the United States in the Course of Performing a Construction Contract and Those Who Transfer Similar Property Without Attaching It to Realty?*

Howell finally argues that there is no rational basis for distinguishing between United States contractors who make improvements to real property and those who simply transfer property to the United States without attaching it to realty. The State, however, has broad discretion in making classifications in a system of taxation. "Where taxation is concerned and no specific federal right, apart from equal protection, is imperiled, the States have large leeway in making classifications and drawing lines which in their judgment produce reasonable systems of taxation." *Lehnhausen v. Lake Shore Auto Parts Co.*, 410 U.S. 356, 359, 93 S.Ct. 1001, 1003, 35 L.Ed.2d 351 (1973) (footnote omitted). The fact that use in a construction project changes the form of property otherwise sold on an outright item-by-item basis provides a rational basis for the state to distinguish between the two types of transfers.

CONCLUSION

The California Sales and Use Tax, as applied to federal contractors, does not levy a direct tax upon the United States. Further, Regulation 1521 is not inconsistent with the California statutory scheme and does not impermissibly discriminate between contractors who make improvements to real property and those who transfer similar property without attaching it to realty. The district court is AFFIRMED.

APPENDIX B

IN THE

UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

Civil No. C 81-4504 SW

Bankruptcy No. 4-79-0344-W

In re EDWARD W. W. HOWELL
d/b/a HOWELL ELECTRIC COMPANY,

Debtor.

EDWARD W. W. HOWELL,
d/b/a HOWELL ELECTRIC COMPANY,

Debtor-Appellee,

v.

STATE OF CALIFORNIA BOARD OF EQUALIZATION,

Claimant-Appellant.

MEMORANDUM AND ORDER REVERSING BANKRUPTCY COURT RULING

This case is before the court on appeal from a September 23, 1981 ruling of the Bankruptcy Court disallowing Claim No. 33 against debtor Edward W. W. Howell, dba Howell Electric Company ("Howell"). The claimant-appellant, the State of California Board of Equalization, sought review of the decision, contesting the lower court's invalidation of California's Sales and Use Tax Law as applied to federal contractors. After hearing oral argument on March 2, 1982, and considering the extensive briefs filed by the parties, the record on appeal and correspondence from the parties discussing recent case law developments, it is hereby ordered that the Bankruptcy Court's ruling is REVERSED.

Howell, an electrical contractor, challenged the constitutionality of the State's sales and use tax on work he performed as a contractor to agencies of the United States Government. The Bankruptcy Court found that California's taxation of both "materials" and "fixtures" used in construction projects impermissibly discriminates against contractors doing business with the Federal Government, and disallowed the claimed taxes on Supremacy Clause grounds.

State taxes directly on the Federal Government are clearly forbidden under *McCulloch v. Maryland,* 4 Wheat. (17 U.S.) 316 (1819). The states are similarly precluded, under the Supremacy Clause, from discriminatory taxation of private parties doing business with the Federal Government. *See, e.g., Phillips Chemical Co. v. Dumas Independent School District,* 361 U.S. 376, 383 (1960). The states are not barred, however, from taxing those who deal with the Federal Government, "so long as the tax is imposed equally on the other similarly situated constituents of the State." *United States v. County of Fresno,* 429 U.S. 452, 462 (1976). A tax is not invalid merely because it treats those dealing with the Federal Government differently than others; the test is whether the actual tax burden borne by a party dealing with the Federal Government is heavier than that felt by a similarly situated party doing business with a private project owner. *Washington v. United States,* 43 CCH S.Ct. Bull. P. B1627, B1635 (1983).

The Tax on Materials

California defines both federal and non-federal contractors as "consumers" of materials.[1] Cal. Admin. Code tit. 18, R. 1521(b)(1)(A), -(b)(2)(A) (1979). Under this scheme, the taxable sale of materials that ultimately go into a construction project takes place between the supplier of the materials and the contractor. Federal and non-federal contractors appear to

[1] "Materials" are defined under regulation 1521 as tangible personal property which, when combined with other tangible personal property in a construction project, loses its identity and becomes an "integral and inseparable part of the real property." Cal Admin. Code tit. 18, R. 1521(a)(4) (1979).

be treated equally under this arrangement. Nonetheless, the Bankruptcy Court found the materials tax to effectively discriminate against federal contractors, on the ground that federal contractors cannot constitutionally "compel" reimbursement from the Federal Government for this tax, while non-federal contractors can obtain such reimbursement from their project owners.

However, as the Supreme Court recently noted, "the [Federal] Government's right to be free from state taxation 'does not spell immunity from paying the added costs, attributable to the taxation of those who furnish supplies to the Government and who have been granted no tax immunity.' " *United States v. New Mexico,* 455 U.S. 720, 734 (1982) (quoting *Alabama v. King & Boozer,* 314 U.S. 1, 9 (1941)). A federal contractor may thus constitutionally "pass on" to the Federal Government California's materials tax as part of its overall costs of performance under the contract, just as a non-federal contractor might with its project owner. Because both types of contractors may pass through this materials tax to the project owners, the federal contractor is not discriminated against vis-a-vis non-federal contractors. Because the tax is in fact imposed equally on other similarly situated constituents of the State, the tax does not violate the Supremacy Clause. *Fresno* at 462.

The Bankruptcy Court's reliance on *Kern-Limerick, Inc. v. Scurlock,* 347 U.S. 110 (1954), holding unconstitutional a tax on federal contractors who act as purchasing agents of the Federal Government, is also inapposite. In *Kern-Limerick* it was "clear that the Government is the disclosed purchaser," not the contractor, *id.* at 120-21, and thus the tax was held to fall squarely upon an agent of the Federal Government. The Supreme Court has since explained that a finding of constitutional tax immunity "requires something more than the invocation of traditional agency notions . . . a private taxpayer must actually 'stand in the Government's shoes' [citations omitted]." *New Mexico* at 736. In the instant case, there is no firm basis upon which to rest even a finding of "traditional agency," much less a finding so explicit as that of *Kern-*

Limerick or so complete as required by *New Mexico.*[2] California's tax on materials sold to federal contractors, therefore, does not violate the Supremacy Clause.

The Tax on Fixtures

California distinguishes between federal and non-federal contractors regarding the taxation of fixtures.[3] Non-federal contractors are defined to be retailers of fixtures to a project owner, whereas federal contractors are considered as consumers of fixtures. Cal. Admin. Code tit. 18, R. 1521(b)(1)(A), -(b)(2)(B). By making federal contractors consumers, rather than retailers selling to the federal government, the State avoids laying a tax directly on the Federal Government, yet manages to collect a sales tax on the fixtures by taxing their sale *to* the federal contractor. The Bankruptcy Court viewed such differential treatment accorded federal contractors as unconstitutionally discriminatory against those doing business with the Federal Government, and thus disallowed the Board's claims against Howell for the fixtures tax on work Howell performed for the Federal Government. The issue framed upon appeal is whether the California fixtures tax does in fact discriminate against federal contractors. Howell contends that because federal contractors must pay a sales tax to their suppliers of fixtures, while in non-federal projects the contractor is not so burdened (since the non-federal project owner pays the sales tax), the tax is discriminatory.

The Supreme Court has recently addressed a very similar question, in *Washington v. United States,* 43 CHH S.Ct. Bull. P. B1627 (1983). The State of Washington defines non-federal contractors as retailers for sales tax purposes, but treats federal contractors as consumers of the tangible personal property used in a project. Wash. Rev. Code § 82.04.190 (1981). Like California's fixtures tax, this scheme avoids a direct tax on the

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[2] The only evidence of an agency relationship cited to this court consists of the bidding instructions for the federal contract, which provided that sales taxes were to be excluded in preparing the bids.

[3] "Fixtures" under Regulation 1521 are tangible personal property which are accessory to a structure, and which do not lose their identity when installed. Cal. Admin. Code tit. 18, R. 1521(a)(5).

Federal Government, yet allows the state to collect a sales tax on the sale of tangible personal property by a supplier to a contractor.[4] The Supreme Court upheld the tax, stating that the "important consideration. . . is not whether the State differentiates in determining what entity shall bear the legal incidence of the tax, but whether the tax is discriminatory with regard to the economic burdens that result." *Id.* at B1636. Thus a tax scheme does not unconstitutionally discriminate between federal and non-federal contractors merely by varying the route by which the tax arrives at the respective contractors' doorsteps; the relevant question is whether a different form of taxation forces the federal contractor to actually shoulder "a cost he would not have to bear if he were to do the same work for a private party." *Id.* at B1633 n.4.

Simply stated, the test for discrimination is whether the tax as a whole "treats someone else better" than it treats a similarly situated federal contractor. *Id.* at B1636. *See also Fresno*, 429 U.S. at 462. Given two construction projects identical except for the fact that the Federal Government owns one of the projects and a private party owns the other, simple mathematics indicates that a fixed tax on equal quantities of fixtures will result in an identical total economic burden on each of the projects. It is this total burden which is shared by the contractor and the project owner. In both the federal and non-federal situations, the relative bargaining strength of the parties to the contract determines the actual allocation of the burden of the sales tax. In both types of projects the tax will be taken into account by the contractor in setting its price. The only difference between the two situations is that the federal contractor will incorporate whatever portion of the sales tax it is economically capable of passing along into the price it charges the Government, whereas the price set by the non-federal contractor will reflect a reduction for whatever portion of the

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[4] Unlike California, Washington makes the consumer/retailer distinction with regard to all tangible personal property that goes into a construction project, not just fixtures. This difference does not affect the applicability of *Washington* to the instant case. Moreover, while this court acknowledges several other superficial distinctions between the challenged California tax scheme and the statutes upheld in *Washington*, none alter the basic identity of the two systems of taxation.

tax it is incapable of leaving on the project owner. *Washington* at B1633 n.4. The result is that both the federal *and* non-federal contractor will share, to a similar extent in similar situations, the burden of the sales tax with the project owner. Although the incidence of the tax is on a different, earlier transaction in the case of a federal project, the economic burden on the federal contractor will be no more than that borne by a similarly situated non-federal contractor.[5]

Therefore, like Washington, California "has not singled out contractors who work for the United States for discriminatory treatment." *Id.* at B1637. Rather, "[i]t has merely accomodated for the fact that it may not impose a tax directly on the United States as the project owner." *Id.* Under the *Washington* test, California's taxation of fixtures sold to federal contractors is not unconstitutional.

For the foregoing reasons, the decision of the Bankruptcy Court disallowing the Board's Claim No. 66 is REVERSED, both as to the tax on materials and fixtures. The case is REMANDED for further proceedings consistent with this opinion.

IT IS SO ORDERED.

SPENCER WILLIAMS

United States District Judge

DATED: 5/26/83

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[5] *United States v. California State Board of Equalization*, 650 F.2d 1127 (9th Cir. 1981), *aff'd per curiam*, 102 S.Ct. 1744 (1982), cited by Howell, does not deal with the issue presented by the instant case. *State Board of Equalization* addressed the issue of whether, and when, the *legal incidence* of a tax on a transaction to which the Federal Government is a party may properly be said to fall directly upon the Federal Government. The issue herein is whether a tax with legal incidence upon a transaction between a supplier of fixtures and a federal contractor discriminates against federal contractors, where a tax identical in form is not placed upon such transactions involving non-federal contractors. The test here "is not whether the State differentiates in determining what entity shall bear the legal incidence of the tax, but whether the tax is discriminatory with regard to the economic burdens that result." *Washington* at B1636.

IN THE

UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

Civil No. C 81-4504 SW

Bankruptcy No. 4-79-0344-W

MODIFICATION OF FINAL ORDER REVERSING BANKRUPTCY COURT

In re EDWARD W.W. HOWELL,
d/b/a HOWELL ELECTRIC COMPANY,

Debtor.

EDWARD W.W. HOWELL,
d/b/a HOWELL ELECTRIC COMPANY,

Debtor-Appeliee,

v.

STATE OF CALIFORNIA BOARD OF EQUALIZATION,

Claimant-Appellant.

ORDER MODIFYING FINAL ORDER REVERSING BANKRUPTCY COURT

For good cause shown, IT IS HEREBY ORDERED that footnote 2 at page 8, lines 8-11, are hereby deleted from this Court's order filed May 26, 1983. The opinion is modified to read:

[2] There was no evidence in the record to support the apparent misimpression of the bankruptcy court that the instructions under which Howell was to bid for federal contracts, required Howell not include any sales or use taxes in the contract price.

IT IS SO ORDERED.

SPENCER WILLIAMS

United States District Judge

DATED: JUN 17 1983

APPENDIX C

UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

No. 4-79-0344-W

In re EDWARD W.W. HOWELL,
d/b/a HOWELL ELECTRIC COMPANY,

Debtor.

RULING ON DEBTOR'S OBJECTION TO CLAIM NO. 66—STATE BOARD OF EQUALIZATION

The objection of the debtor to claim no. 66 in this case filed by the Board of Equalization of the State of California, was heard on August 26th, 1980, GEORGE DEUKMEJIAN, Attorney General by PATRICIA STRELOFF, Esq., Deputy Attorney General, appearing for the State Board, and JOEL T. GUTHRIE, Esq. appearing for debtor. Each party presented evidence consisting of a stipulation of facts, the testimony of witnesses, and documents. The questions presented have been extensively briefed by the parties in pretrial and post-trial memoranda.

Debtor, an electrical contractor, performed work as a contractor or subcontractor pursuant to several contracts with agencies of the United States Government during the period April 1, 1976, to February 12, 1979. Each contract involved the performance of work and installation of materials and fixtures on property owned or controlled by an agency of the United States Government. As to each such contract, the bidding instructions required that the contractor not include any California Sales or Use Taxes. Debtor in its bid did not include any amount for such taxes. Upon audit and re-audit, the State Board claims Sales and Use Taxes are due from debtor in the total amount of $60,661.00 for the period in question.

Debtor has stipulated that the sum of $24,790.00 assessed as Sales or Use Taxes upon materials used in the jobs is payable and the State Board's claim should be allowed in said amount. The balance of the claim is disputed upon the ground that the California Sales and Use Tax scheme sought to be enforced by the State Board is unconstitutional in that it impermissibly discriminates against U.S. contractors such as debtor. The provisions involved are § 6051 et seq and § 6201 et seq of the California Sales and Use Tax Law imposing a tax upon sellers who make retail sales and users ("storage use or other consumption") of tangible personal property purchased from any retailer, and § 1521 of the California Administrative Code.

Since this matter came under submission, the court's law clerk has expended extensive time in researching the law surrounding intergovernmental taxation. The issue herein is one of great complexity arising out of the necessarily arbitrary definitions and principles peculiar to the area of taxation. Because of the sensitive nature of interaction between the federal and state governments and the need for both to raise sufficient revenues from taxes levied on invariably the same pockets, the bar against state taxation of federal functions posed by the supremacy clause has produced a lengthy history of cases not readily reconcilable with each other.

The case of *United States v. State of Washington,* No. 78-1424 ____ F.2d ____ (C.9, 1980), was brought to this court's attention as presenting substantially the same issue as that in the instant case, albeit involving sales tax provisions of the State of Washington. This case has been pending before the Ninth Circuit since May 1980. On August 24, 1981, the court in an opinion by Judge William Matthew Byrne, Jr., District Judge for the Central District of California, sitting by designation, handed down its decision distilling the following principle which this court holds to be controlling in the instant case: "A tax may be imposed upon those who deal with the federal government only if the burden of the tax is equally felt by those 'similarly situated' who do not deal with the federal government."

In 1975, Washington sales tax code provisions, the effect of which theretofore had made the owner of real property improvements liable as a consumer for sales tax on personal property incorporated therein to be collected and remitted to the state by the prime contractor as retailer, were amended in such a manner as to cause U.S. prime contractors to be treated as the consumer of personal property incorporated into federal real property improvements. Non-U.S. contractors continued to be treated as retailers, having no personal liability for the sales tax but having an obligation to collect the tax from the improvement owner and remit it to the state. The effect of the 1974 amendments was to force a U.S. prime contractor to pay out-of-pocket the amount of the tax if it could not compel reimbursement from the federal government.

Like the State of California in the instant case, the State of Washington relied principally on *United States v. County of Fresno,* 429 U.S. 452 (1977), and *United States v. City of Detroit,* 355 U.S. 466 (1958), in which the U. S. Supreme Court declared that renters (*Fresno*) and users (*Detroit*) of tax-exempt property could contitutionally be taxed to the same extent as were owners of non-exempt real property who passed the tax on to their lessees. The court adopts the Ninth Circuit's discussion of those cases as applicable in the instant case.

The opinion rejects the State of Washington's attempt to draw a parallel between the position of renters/users in the above cases and that of U.S. prime contractors required by the challenged statutes to pay sales taxes otherwise imposed on owners of non-federal real property improvements. The statutory class of "consumers" was an artificial one composed of taxpayers not similarly situated, namely, U.S. prime contractors and owners of non-federal real property improvements. Furthermore, the tax scheme placed a financial burden only on U.S. prime contractors, not on non-U.S. prime contractors as well, so that the political check against abusive taxation or interference with federal functions did not exist. (See *M'Culloch v. Maryland* (1819) 4 Wheaton 316.) Finally, any attempt to equalize the tax burden as between the U.S. and private real property improvement owners is barred by the

supremacy clause, whether the means thereto be a direct tax on the U.S. or a discriminatory tax on those who deal with the United States.

In view of the foregoing discussion, it follows that the California Sales and Use Tax is unconstitutionally discriminatory as levied on U.S. contractors if it forces the U.S. contractor to go out-of-pocket in the amount of the sales tax while at the same time the non-U.S. contractor is not compelled to go out-of-pocket in that amount. Based on the following review of the California Sales and Use Tax Law as implemented by specific regulations, the court finds the tax unconstitutionally discriminatory and void with respect to U.S. contractors.

Preliminarily, the state's briefs cited *C.R. Fedrick, Inc. v. State Board of Equalization* 120 Cal. Rptr. 434 (1974) for the proposition that the state has the power to tax U.S. contractors differentially. However, in matters of taxation where a federal right is concerned, the characterization given to a state tax by state courts or legislatures is not binding on a federal court, nor does such characterization relieve a federal court from the duty of considering the real nature of the tax and its effect upon the federal right asserted. *Carpenter v. Shaw* 280 U.S. 363 (1929), at 367 and 368.

When a discriminatory tax is alleged, such that it is necessary to determine how other taxpayers similarly situated are treated, an examination of the entire tax structure is required if the provision imposing the tax does not sufficiently reveal such treatment. *Phillips Co. v. Dumas School District* 361 U.S. 376 (1960), at 383. It is the net effect of tax provisions and regulations that determines the question of discriminatory taxation rather than solely the explicit language of specific provisions and regulations.

§ 6007 of the California Revenue and Taxation Code defines a retail sale as one for any purpose other than resale in the regular course of business. Without more, any contractor who buys materials and other tangible personal property for resale by incorporation into real property improvements pas-

sing on the cost thereof to the ultimate owner can be a person engaged in the resale of goods in the regular course of business on whom no tax liability falls.

Former § 6052, at all times relevant to this case, reads: "The tax hereby imposed shall be collected by the retailer from the consumer insofar as it can be done." Since the decision in *Western Lithograph Co. v. State Board of Equalization* 11 C. 2d 156 (1934), at 162, former § 6052 has been construed as a vendor tax which the vendor could, but had no mandatory duty to, pass on to the purchaser. Under former § 6052 and present § 6207, the retailer who holds out directly or indirectly that he will absorb the sales or use tax or any part of it is guilty of a misdemeanor. Reading those provisions together, the California courts for forty years or more have deemed former § 6052 to "permit" the non-U.S. to reimburse itself by charging the owner an additional amount representing tax for remittance to the state, but at the same time to forbid the U.S. contractor to attempt to collect the same amount from the federal agency because of the constitutional prohibition against a direct tax on the United States.

Since a U.S. contractor is forbidden to collect the sales tax from the federal agency under former § 6052, the state appears to "lose" a fair amount of sales tax revenue. To reduce the perceived loss, the legislature enacted § 6007.5 which states in pertinent part: "A sale of tangible personal property to a property . . . is use in the performance of a contract with the United States for the construction of improvements on or to real property . . . is a retail sale." The effect of § 6007.5 is to require the supplier of materials and personal property to a U.S. contractor who intends to use those items in improving federal real property to collect the sales tax from the U.S. contractor prior to transfer and incorporation of those items into the federal improvement.

Up to this point, the effect of the California tax provisions appears to be remarkably like that of the amended Washington State tax provisions that Judge Byrne found constitutionally impermissible with respect to federal contractors in that state. A further examination of the regulations regarding the Califor-

nia statutory provisions does nothing but confirm the discriminatory effect of the California sales tax structure as a whole with regard to U.S. contractors.

Although § 6007.5 refers only to U.S. contractors, regulation 1521 was promulgated to implement that and other related sales and use tax provisions concerning all contractors. Regulation 1521 divides tangible personal property used in real property improvement construction into three categories destined for different tax treatment: machinery or equipment, materials and fixtures.

On the face of it, Regulation 1521 appears to treat all contractors identically with respect to the first and second categories, that is, machinery or equipment and materials. It provides that all contractors are retailers of machinery or equipment. Logically, non-U.S. contractors are retailers because § 6007.5 by its terms applies only to U.S. contractors. As retailers, notwithstanding the construction of § 6052 in *Western Lithograph,* non-U.S. contractors are compelled by former § 6053 and present § 6207, the misdemeanor sections, to collect the sales tax thereon from the owner of the improvement for remittance to the state—literally to pass on the sales tax. On the other hand, U.S. contractors are effectively made retailers of machinery or equipment by dint of § 6381 which provides an exemption from the sales tax for sales of goods of that category to the U.S. government. Thus, as retailers of machinery or equipment, but for utterly different reasons, U.S. and non-U.S. contractors are not liable out of their own pockets for payment of the sales tax to their suppliers for remittance to the state.

With respect to the category called "materials" Regulation 1521 appears to accord all contractors equal treatment by requiring their suppliers to collect the sales tax from them regardless of the nature of the owner of the real property improvement. But the appearance of equal treatment is only that. Whereas non-U.S. contractors may reimburse themselves by adding the amount of the tax to the overall cost passed on to the owner of the real property improvements, the U.S. contractor may not compel the federal agency to pay the amount representing the sales tax.

Counsel for the state in her brief and in oral argument maintains that the regulation concerning materials merely reflects business reality in that U.S. contractors add on the amount of the sales tax and charge the federal agency that amount even if they do not explicitly separate that cost item out of the bid presented to the federal government. Since the time of *Alabama v. King & Boozer* 314 U. S. 1 (1941), it has been thought the federal government constitutionally can permit itself to be taxed by the state concerning such contracts for construction. However, in *Kern-Limerick, Inc. v. Scurlock* 347 U.S. 110 (1954) the U.S. Supreme Court held that if the prime contract made the contractor a purchasing agent for the government then no state sales tax could be levied on the contractor because the real purchaser under the contract is the federal government.

In general, today, federal contracting has taken on the business terms found in *Kern-Limerick, Inc.* The uncontroverted testimony in this case was that the contracts to which HOWELL was party were let with instructions to the effect that all sales taxes were to be excluded in making up the bid.

HOWELL and similarly situated U.S. contractors cannot compel the federal agency to reimburse them for the cost of the sales tax. Under the tax provisions and regulations, nevertheless, HOWELL and others similarly situated must pay the tax to the state. The business reality of which counsel for the state spoke does not obtain in this case. Nor do the tax provisions and regulations provide for differentiating between sales pursuant to *King and Boozer* contracts as opposed to *Kern-Limerick* contracts to prevent forcing a U.S. contractor out-of-pocket.

Under the Ninth Circuit decision in *U.S. v. State of Washington* it is constitutionally impermissible under the supremacy clause to levy a tax that places a greater burden on one who deals with the federal government than it does on one similarly situated who does not deal with the federal government. The California sales tax as applied to transfers of materials to be incorporated into federal real property improvements is void under this rule of law notwithstanding the fact

that terms of the regulation concerning materials appear to accord equal treatment to U.S. and non U.S. contractors.

With respect to the third category of tangible personal property in construction contracts, Regulation 1521 in bald terms declares U. S. contractors consumers of fixtures and non-U. S. contractors retailers thereof, openly stating the intended difference in tax treatment of similarly situated taxpayers who differ only as regards the nature of the entity with which they deal. Like § 6007.5, this regulation on its face provides for different treatment that in reality results in disparate and disadvantageous treatment of one who deals with the federal government and is therefore void.

In summary, the court disallows the claimed taxes upon fixtures and materials upon the ground that the taxing scheme is impermissibly discriminatory as to U. S. Government contractors such as debtor herein. Notwithstanding the stipulation, the court does not allow the sales and use taxes assessed upon materials for the reason that under the case of *U.S. v. State of Washington* which the court deems controlling, the taxes assessed are discriminatory and entirely void. Federal courts have no authority to recognize such a tax. *Moses Lake Homes v. Grant County* (1960) 365 U.S. 744. Further, in passing upon a claim the court is not bound by a stipulation of debtor who is not acting in his own behalf in this instance but on behalf of creditors upon whom the loss would fall if the claim is improperly allowed. Such stipulations are subject to review and approval or disapproval by the court. It follows that the claim of the State Board should be disallowed in toto. In view of the foregoing findings and conclusions, it is not necessary to determine whether the items questioned are equipment or fixtures.

IT IS ORDERED that claim no. 66 is disallowed.

CAMERON W. WOLFE

Cameron W. Wolfe
Bankruptcy Judge

Dated: September 23, 1981

APPENDIX D

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

No. 83-2124
C-81-4504-SW, 4-79-0344-SW

In re: EDWARD W.W. HOWELL,
d/b/a HOWELL ELECTRIC CO.,

Debtor.

EDWARD W.W. HOWELL,
d/b/a HOWELL ELECTRIC CO.,

Debtor/Appellant,

vs.

THE STATE BOARD OF EQUALIZATION,

Claimant/Appellee.

Judgment

APPEAL from the United States District Court for the Northern District of California

THIS CAUSE came on to be heard on the Transcript of the Record from the United States District Court for the Northern District of California and was duly submitted.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court, that the judgment of the said District Court in this Cause be, and hereby is affirmed.

Filed and entered April 19, 1984

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 83-2124

DC No. C 81-4504 SW

In re: EDWARD W.W. HOWELL,
d/b/a HOWELL ELECTRIC COMPANY,

Debtor.

EDWARD W.W. HOWELL,
d/b/a HOWELL ELECTRIC COMPANY,

Debtor/Appellant,

v.

THE STATE BOARD OF EQUALIZATION,

Claimant/Appellee.

ORDER

Before: HUG and FERGUSON, Circuit Judges, and BYRNE*, District Judge

The petition for rehearing is denied.

Filed June 4, 1984

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*Hon. Wm. Matthew Byrne, Jr., United States District Judge, Central District of California, sitting by designation.

No. 84-353

Office - Supreme Court, U.S.
FILED
OCT 10 1984
ALEXANDER L. STEVAS
CLERK

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1984

In Re EDWARD W.W. HOWELL,
d/b/a HOWELL ELECTRIC COMPANY,
Debtor.

EDWARD W.W. HOWELL,
d/b/a HOWELL ELECTRIC COMPANY,
Petitioner,

vs.

THE STATE BOARD OF EQUALIZATION,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals For the Ninth Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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59 pp

QUESTION PRESENTED

Petitioner in this matter purchased certain tangible personal property for his use in constructing improvements to real property belonging to the United States. California law specifically provides that a sale of tangible personal property to be used for such purposes is a taxable "retail sale." Petitioner nevertheless purchased the property in question from his suppliers on a tax-free basis, certifying to them that the property was being purchased for resale. Pursuant to section 6094 of the California Revenue and Taxation Code, the State Board of Equalization subsequently assessed use taxes against petitioner measured by the purchase price of the property. The question presented is:

Did the Court of Appeals err in holding that the use taxes assessed against petitioner do not constitute direct taxes on the United States?

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No. 84-353

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1984

In Re EDWARD W.W. HOWELL,
d/b/a HOWELL ELECTRIC COMPANY,
Debtor.

EDWARD W.W. HOWELL,
d/b/a HOWELL ELECTRIC COMPANY,
Petitioner,

VS.

THE STATE BOARD OF EQUALIZATION,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals For the Ninth Circuit

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RESPONDENT'S BRIEF IN OPPOSITION

Respondent respectfully requests that this Court deny the petition for writ of certiorari, seeking review of the Ninth Circuit's opinion in this case. That opinion is reported at 731 F.2d 624.

RELEVANT STATUTES AND REGULATORY PROVISIONS OMITTED FROM PETITION

This case involves a number of provisions of the California Revenue and Taxation Code which have not been included in the listing provided by petitioner. These provisions are quoted in full or in relevant part below.[1]

§ *6091. Presumption that gross receipts subject to tax: Burden of proof:*

> "For the purpose of the proper administration of this part and to prevent evasion of the sales tax it shall be presumed that all gross receipts are subject to the tax until the contrary is established. The burden of proving that a sale of tangible personal property is not a sale at retail is upon the person who makes the sale unless he takes from the purchaser a certificate to the effect that the property is purchased for resale."

§ *6094. Effect of using article bought for resale:*

> "(a) If a purchaser who gives a resale certificate makes any use of the property other than retention, demonstration, or display while holding it for sale in the regular course of business, the use shall be taxable to the purchaser under Chapter 3 (commencing with Section 6201 of this part) as of the time the property is first used by him, and . . . the sales price of the property to him shall be the measure of the tax. • • •"

§ *6094.5. Giving resale certificate for property not to be resold (as amended Stats. 1977, ch. 607):*

> "(a) Any person who gives a resale certificate for property which he knows at the time of purchase is not

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[1]All of the statutes listed are located in Deering's Annotated California Codes.

to be resold by him in the regular course of business for the purpose of evading payment to the seller of the amount of the tax applicable to the transaction is guilty of a misdemeanor.

"(b) Any person who gives a resale certificate for property which he knows at the time of purchase is not to be resold by him in the regular course of business is liable to the state for the amount of tax that would be due if he had not given such resale certificate."

§ *6201. Imposition and rates of tax:*

"An excise tax is hereby imposed on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer on or after July 1, 1935, for storage, use, or other consumption in this state * * *."

§ *6008. "Storage":*

"'Storage' includes any keeping or retention in this State for any purpose except sale in the regular course of business. . . ."

§ *6202. Persons liable for tax: Extinguishment of liability:*

"Every person storing, using, or otherwise consuming in this State tangible personal property purchased from a retailer is liable for the tax. This liability is not extinguished until the tax has been paid to this State except that a receipt from a retailer engaged in business in this State . . . given to the purchaser pursuant to Section 6203, is sufficient to relieve the purchaser from further liability for the tax to which the receipt refers."

Also involved in the case is Sales and Use Tax Regulation 1521 (18 Cal. Admin. Code § 1521), which sets forth detailed rules pertaining to the application of the sales and use tax law to both private contractors[2] and contractors

[2]The term "private contractors" as used herein refers to contractors doing business either with private parties or with the State of California and its political subdivisions.

doing business with the United States. Due to its length, the Regulation is reproduced in the accompanying Appendix.

STATEMENT OF THE CASE

Introduction

This is an action challenging provisions of the California Sales and Use Tax Law relating to construction contractors doing business with the United States—provisions which have gone unchallenged by the Federal Government itself in the nearly 50 years they have been in existence. Petitioner is Edward W.W. Howell, dba Howell Electric Co. (hereinafter "Howell"), an electrical contractor who has been operating since early 1979 under Chapter XI of the former Bankruptcy Act.[3] Respondent is the California State Board of Equalization (hereinafter "the Board"), which is the agency of the State of California empowered to assess and collect liabilities arising under the California Sales and Use Tax Law.

The petition for review by this Court reflects a lack of respect for the appellate process. As will be developed more fully below, the question which petitioner has placed before this Court was not argued or considered in the courts below. In fact, with a chameleon-like quality, Howell has made a different legal argument in each of the four federal courts in which he has sought relief.

Moreover, in his eagerness to obtain a hearing before this Court, Howell has not only misrepresented applicable California law, but has effectively altered the record to suit his purpose. For example, in his "Statement of the Case," Howell baldly declares that title to property subjected to use taxes by California vested in the United States prior to any use by him as though that were a "fact" established by the record. See Petition for Writ of Certiorari (herein-

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[3]The Bankruptcy Reform Act of 1978 took effect on October 1, 1979. Howell filed bankruptcy proceedings on February 12, 1979.

after "Pet."), at 5; 10-12. On the contrary, the assertion that Howell made no use of the property prior to its transfer to the United States is a legal conclusion which Howell has belatedly reached on his own. The proposition was never considered in the courts below. It is unsupported by the facts of record and is legally indefensible.

The California Sales and Use Tax Law: In General

The California sales tax is imposed on a retailer's gross receipts from the retail sale of tangible personal property within the state. Cal. Rev. & Tax. Code § 6051.[4] Section 6007 defines a "retail sale" as meaning "a sale for any purpose other than resale in the regular course of business in the form of tangible personal property." The term "retailer" is defined in section 6015 as including "[e]very seller who makes any retail sale or sales of tangible personal property." The term "seller" is defined in section 6014 as including "every person engaged in the business of selling tangible personal property of a kind the gross receipts from the retail sale of which are required to be included in the measure of the sales tax."

Section 6201 imposes a complementary use tax on the storage, use or other consumption in California of tangible personal property purchased from a retailer in a transaction not subject to sales tax. Cal. Rev. & Tax. Code § 6401. Generally, use tax rather than sales tax is applicable in one of two situations: (1) where the property has been purchased from an out-of-state retailer; or (2) where the property has been purchased in California under a "resale certificate" but is used by the purchaser prior to resale. See, e.g., *McConville v. State Bd. of Equalization*, 85 Cal.App. 3d 156, 159, 149 Cal. Rptr. 194 (1978).

The use tax is a direct obligation of the purchaser, Cal. Rev. & Tax. Code § 6202, though, under certain circum-

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[4]All statutory references are to the California Revenue and Taxation Code unless otherwise noted.

stances, the retailer may be required to collect it. See, e.g., *National Geographic v. Cal. Equalization Board,* 430 U.S. 551 (1976). In *Diamond National v. State Equalization Bd.,* 425 U.S. 268 (1976), this Court ruled that for purposes of federal immunity, the legal incidence of the sales tax also falls upon the purchaser. The long-held view of the California courts that the legal incidence of the sales tax falls upon the retailer, see, e.g., *Western Lithograph Co. v. State Bd. of Equalization,* 11 Cal.2d 156, 163-164, 78 P.2d 731 (1938), continues to be followed in situations in which a question of federal immunity is not involved. See, e.g., *United States v. State Bd. of Equalization,* 693 F. 2d 458, 465 (9th Cir. 1981), cert. den., 451 U.S. 1028 (1981); *Occidental Life Ins. Co. v. State Bd. of Equalization,* 135 Cal. App. 3d 845, 848-851, 185 Cal. Rptr. 779 (1982).[5]

Application of Sales and Use Taxes Under Regulation 1521

The application of the California Sales and Use Tax Law to construction contractors is set forth in Regulation 1521 (18 Cal. Admin. Code § 1521). This regulation distinguishes between three types of tangible personal property typically used or installed on a construction project: "materials," "fixtures," and "machinery and equipment." Broadly defined, "materials" are items which become an

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[5]Howell's discussion of these general principles is garbled at best. First, he states that the distinguishing characteristic of a "vendee" type tax is that "the seller is statutorily entitled to reimbursement of that tax from the buyer." Pet., at 6. At least insofar as the California use tax is concerned, this is inaccurate. The use tax is a "vendee" type tax for the simple reason that it is a direct obligation of the purchaser. It is not a tax levied on the seller which the law permits or requires the seller to "pass on" to the purchaser.

Second, after having lumped together the California sales and use taxes, Howell states that "Although California has characterized its *tax* as a vendor type tax, this Court has found that, as a matter of federal law, the legal incidence of *the tax* falls upon the vendee." *Id.* (emphasis added). The *Diamond National* case raised a question as to the legal incidence of a *sales tax* levied on a *sale* of

integral part of realty; "fixtures" are items which become an accessory to a structure; and "machinery and equipment" are items which incidentally may be attached to realty but do not lose their identity as tangible personal property when so attached.

The tax treatment with respect to the three types of property described above is as follows:

Both United States and private contractors are regarded as retailers of "machinery and equipment." Accordingly, such property may be purchased by a United States contractor under a resale certificate, and no tax is due on its subsequent transfer to the Federal Government. In all other cases, the transfer of machinery and equipment from a contractor to the project owner constitutes a taxable sale.

Both United States and private contractors are regarded as consumers of "materials."[8] Accordingly, sales tax is due on the sale of the materials to the contractor, or, if such materials have been purchased under a resale certi-

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tangible personal property to a federal instrumentality. The incidence of the use tax is indisputably upon the purchaser, and California has never contended otherwise.

Finally, Howell says that "The difference between the two types of sales and use taxes [i.e., "vendor" and "vendee"] becomes critical when sales to the United States are involved" because "the legal incidence of a vendee type tax falls on the United States. . . ." *Id.* This is correct, of course, only when the taxed transaction *is* a sale to the United States and the United States *is* a vendee. Howell's observation is not germane to the present case since the transaction giving rise to the asserted liability was Howell's purchase of construction materials from his suppliers, not the "purchase" by the United States of the completed improvements.

[8]This has been true since at least 1939, when the first regulation dealing with construction contractors was adopted. Howell's assertion that only United States contractors are classified as consumers of materials, see Pet., at 8, n. 6, is inexplicable.

ficate, use tax is due on the contractor's use of the materials in the performance of his contract.[7]

With respect to "fixtures," which are items accessory to a structure, the regulation provides for dissimilar treatment of United States and private contractors. United States contractors are classified as consumers of this type of property, and therefore the tax applies in the same manner as the tax on materials. Private contractors, on the other hand, are classified as retailers of fixtures; thus, tax applies to the transfer of the fixtures to the project owner rather than to the sale of the fixtures to the contractor.[8]

The distinction made in the regulation between "materials" and "fixtures" was necessitated by the fact that the California Sales and Use Tax Law applies to the sale of tangible personal property, but not to the sale of services. In general, a building contractor is regarded under the law "as a supplier of services and as a consumer of the building material. . . ." *King v. State Bd. of Equalization,* 22 Cal.

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[7]In a narrow exception to the general rule, a private contractor is not regarded as using "materials" in the improvement of real property when he enters into a "time and material" contract which explicitly provides for the transfer of title to materials prior to installation and separately states the sales price of the materials exclusive of the charge for installation. See Reg. 1521(b)(2)(A)(2). Although some "extras" in the present case were billed on a time and material basis, Reporter's Transcript, at 65, all of the contracts were lump-sum contracts and thus of a type to which the general rule would apply in the case of private as well as governmental contractors.

[8]Generally, in either case, the measure of the tax liability is the cost price of the fixture to the contractor. However, the tax may actually be greater in the case of a contractor doing business with a private party. If such a contractor is also the manufacturer of fixtures, he must pay tax on the cost of the labor and overhead involved in the fabrication, see *Oliver & Williams Elevator Corp. v. State Bd. of Equalization,* 48 Cal.App.3d 890, 122 Cal. Rptr. 249 (1975), while a U.S. contractor under similar circumstances would pay tax only on the cost of materials used in the fabrication.

App. 3d 1006, 1013, 99 Cal. Rptr. 802 (1972); see also *Levine v. State Bd. of Equalization,* 142 Cal.App.2d 760, 768, 299 P.2d 738 (1956); *Gen. Elec. Co. v. State Bd. of Equalization,* 111 Cal.2d 180, 187, 244 P.2d 427 (1952). A contractor may, however, make incidental sales of tangible personal property. It is thus necessary to draw a line between tangible personal property which is sold by a contractor to the project owner and tangible persomal property which is used by him in the rendition of services. This line is drawn by the provisions of Regulation 1521 distinguishing between "materials" which become an integral part of the realty and "fixtures" which become an accessory to a structure.

The differential treatment accorded U.S. and private contractors with the respect to fixtures is based on section 6384 of the California Revenue and Taxation Code, enacted in its original form in 1941. This provision imposes the sales tax "on gross receipts from the sale of *any* tangible personal property to contractors purchasing such property . . . for use in the performance of contracts with the United States for the construction of improvements on or to real property." (Emphasis added.) It therefore accounts for the rule that a United States contractor is a consumer not only of "materials," but of "fixtures" as well.[9]

Regulation 1521 and its predecessors have been repeatedly upheld by the California courts as properly interpreting the statutory provisions in relation to the construction industry. See, e.g., *Gen. Elec. Co. v. State Bd. of Equalization, supra,* 11 Cal.App.2d 180; *Coast Elevator Co. v. State Bd. of Equalization,* 44 Cal.App.3d 576, 118 Cal. Rptr.

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[9]In 1941, the Legislature also provided that "a sale of tangible personal property to a contractor or subcontractor for use in the performance of contracts with the United States for the construction of improvements on or to real property is hereby declared to be a retail sale. . . ." States. 1941, chp. 681, § 9. This provision was incorporated into the Revenue and Taxation Code in 1955 as section 6007.5.

818 (1975); *Honeywell Inc. v. State Bd. of Equalization*, 48 Cal.App. 3d 907, 122 Cal. Rptr. 243 (1975).

The Tax Assessment Against Howell

Howell is an electrical contractor who has been operating under Chapter XI of the former Bankruptcy Act since early 1979. On June 22, 1979, the Board filed Proof of Priority Claim for Taxes in the Chapter XI proceeding. This claim asserted a deficiency under the California Sales and Use Tax Law in the amount of $71,502.34 tax plus interest for the audit period commencing April 1, 1976 and ending February 12, 1979. The asserted liability was calculated on a measure of $1,777,381.00 plus a BART (Bay Area Rapid Transit) tax measure of $171,896.00. Stipulation of Facts, ¶ 1. The $1,777,380.00 figure has since been reduced by $64,661.00. Stipulation of Facts, ¶ 7.

During the audit period covered by the deficiency determination, Howell performed numerous subcontracts for improvement of real property belonging to the United States, and acted as prime contractor on two government projects. Stipulation of Facts, ¶ 4. Tangible personal property which had been used in performing such contracts was purchased by Howell tax free ("ex tax") from various suppliers under resale certificates. Stipulation of Facts, ¶ 1. The asserted deficiency relates to use taxes alleged to be due on the items so purchased.

It is stated in the petition for review that the stipulation of facts entered into by the parties in the Bankruptcy Court "describes in detail the contractual provisions for ownership of the tangible personal property involved in each contract, as well as the federal government's complete control over Howell's activities as a contractor." Pet., at 10. As Howell is well aware, this representation to the Court is untrue.

The only stipulation of the parties bearing on title to the property is contained in Paragraph 15 of the Stipulation of the Facts. This paragraph reads in its entirety as follows:

> "On or about February 12, 1979, Howell was in default of his contractual obligation in the performance of electrical installation contracts on three of the projects listed in Paragraph 4. The parties agree that certain materials purchased by Howell and in inventory at the site of construction were not installed by Howell but passed from Howell's control to the prime contractor prior to installation pursuant to the terms of the respective prime or subcontracts. The Board has asserted in its determination a tax of $7,097.00 on the above described inventory of materials, calculated on a measure of $116,867. Howell contends that the transfer of the inventory from Howell's control to the prime contractor was a sale for resale to the United States Government or, in the alternative, that the Board improperly taxed the material because title thereto was transferred to the United States Government prior to any use by Howell. A copy of the typical title clause included in said prime or subcontracts is attached hereto as Exhibit C."

Exhibit C is of a one-page printed document containing various "boilerplate" provisions commonly included in government contracts. The title clause therein (with underscoring provided by the parties) reads as follows:

> "*All material and work covered by progress payments shall thereupon become the sole property of the Government.* This provision shall not be construed as relieving the Contractor of the sole responsibility for all material and work upon which payments have been made or the restoration of any damaged work, [word illegible] the right of the Government to require the fulfillment of the terms of the contract."

There were no stipulations between the parties regarding the title provisions of any contracts other than those mentioned in Paragraph 15. There were no stipulations at all regarding the control of the United States over Howell's activities. In addition, while all of Howell's contracts "are referenced in" the Stipulation of Facts, see Pet., at 10, n. 8, the record does not contain a copy of Contract No. IFB N62474-76-B7685 ("Job No. 101"), to which Howell makes repeated reference at pages 10-11 of the petition. In fact, with the narrow exception noted above, the record does not contain a copy or recitation of *any* contractual provisions.

Howell also refers to another "fact" which is not of record. He says at page 10 of the petition that he issued a resale certificate to each of his suppliers "indicating that [he] would be reselling the property *to the United States.*" (Emphasis added.) There is no evidence that the United States was mentioned in the resale certificates. The record does include testimony of the auditor to the effect that delivery instructions contained in invoices indicated that Howell generally purchased materials for use on a particular construction project. Reporter's Transcript, at 56. Thus, while Howell was aware that the property was to be used in improving real property belonging to the United States, it is far from clear that his suppliers were privy to that information.

Arguments and Disposition Below

Howell has now sought relief from the Board's assessment in four federal courts, including this one. On each occasion, he has asserted a different legal argument in support of his claim that the treatment of United States contractors under the California Sales and Use Tax Law violates the Supremacy Clause.

In the Bankruptcy Court, Howell argued that the California law unconstitutionally discriminates against U.S. contractors with respect to "fixtures" because U.S. and pri-

vate contractors are treated differently. He conceded, however, that the law does not discriminate against U.S. contractors with respect to the purchase of "materials" since U.S. contractors and private contractors are treated alike. The Bankruptcy Court, declining to accept the concession of Howell, held that the California law unconstitutionally discriminates against U.S. contractors was respect to *both* materials and fixtures. This holding was based on a broad misinterpretation of the statutory provisions as permitting a private contractor to recoup the tax from the project owner as part of the contract price, but prohibiting a governmental contractor from doing the same.

Buoyed by this success in the Bankruptcy Court, but unable to cope with that court's unsupportable conclusion that U.S. contractors are treated differently than private contractors with respect to materials, Howell asserted in the District Court that *only U.S. contractors were properly treated as consumers of materials under the statutory provisions.* See Brief for the Appellee, United States District Court, at 23-26. This theory supplied Howell with the same differential treatment (private contractors as retailers, U.S. contractors as consumers) which he had thus far successfully argued was unconstitutionally discriminatory in the case of fixtures.

The notion that the California law discriminates against U.S. contractors because of differential treatment became untenable when this Court issued its decision in *Washington v. United States,* 103 S. Ct. 1344 (1983). In that case, the State of Washington taxed a United States contractor as a consumer of materials going into a construction project while treating his counterpart in the private sector as making a sale of the completed improvement to the project owner. This Court upheld the Washington law, saying that "The important consideration . . . is not whether the State differentiates in determining what entity shall bear the legal incidence of the tax, but whether the tax is discrimi-

natory with regard to the economic burdens that result." 103 S. C., at 1349.

In light of the controlling authority of the *Washington* case, Howell dropped his discrimination argument in the Ninth Circuit Court of Appeals. He there contended that Regulation 1521 is invalid because there is *no statutory authority for treating U.S. contractors as consumers of either materials or fixtures*. See Opening Brief of Debtor-Appellant, Ninth Circuit Court of Appeals, at 13-16.[10] From this premise, he reasoned that the taxes in question were actually imposed on his "sale" of materials and fixtures to the United States, and that, since for federal purposes the incidence of the *sales tax* is on the purchaser, the asserted taxes were imposed directly on the United States. *Id.*, at 8, 12, 15-16; see also Reply Brief of Debtor-Appellant, Ninth Circuit Court of Appeals, at 9-10. While noting that this contention had not been made below, the Court of Appeals elected to consider its merits. 731 F. 2d, at 626-627. The court found the contention groundless, pointing out that "The transaction between Howell and the United States is not taxed at all; the tax is imposed on the transfer of property from a supplier to Howell." *Id.*, at 628.[11]

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[10]Howell has not sought review of this question in his Petition for Writ of Certiorari, see Pet., at 13, n. 13, but he obviously remains unconvinced that there is statutory authority for the regulation's classification of U.S. contractors as "consumers" of materials and fixtures. See Pet., at 8, n. 6. A U.S. contractor is identified in the regulation as a "consumer" of materials and fixtures for the simple reason that the sale of such property to the contractor is deemed to be a "retail sale"—i.e., the contractor is regarded as purchasing the property for use rather than for resale. Furthermore, as noted by the Court of Appeals, "since the regulation accurately describes the tax consequences of the California Sales and Use Tax Law, the particular word chosen to describe the contractor is immaterial." 731 F. 2d, at 628.

[11]Howell criticizes the latter statement of the Court of Appeals, saying that it "would seem to describe the imposition of a *sales* tax —not a use tax." Pet., at 13 (emphasis in original). He thus con-

By way of a petition for rehearing in the Court of Appeals, Howell sought to raise for the first time the theory which he now advances in this Court: that he was not the owner of the property at the time of its use and therefore the asserted tax is a *use tax* imposed directly on the United States. It was stated in the petition for rehearing that "Howell has argued that title was transferred to the United States before the property was used," and that [i]n order to prevent confusion the court should meet [this argument] squarely. . . ." Petition for Rehearing, Ninth Circuit Court of Appeals, at v. Howell, however, had not made the argument in the Court of Appeals. He had not made the argument in the District Court. He had not made the argument in the Bankruptcy Court, *except with respect to a minor portion of materials which had been left at job sites when the Chapter XI proceedings were instituted.* See, *supra* at 10. Even in this limited context, the question was never reached by the Bankruptcy Court due to its holding that the tax on materials was invalid in its entirety.

REASONS WHY THE WRIT SHOULD BE DENIED

I

THE QUESTION WHICH HOWELL HAS PRESENTED FOR CONSIDERATION BY THIS COURT WAS NOT ARGUED OR CONSIDERED IN THE COURTS BELOW.

This Court has repeatedly indicated its unwillingness to consider questions not raised in the courts below. See, e.g., *G.D. Searle & Company v. Cohn*, 102 S. Ct. 1137, 1143, n.7 (1982); *Delta Air Lines, Inc. v. August*, 450 U.S. 356, 362

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cludes that the Court of Appeals misunderstood the situation. See also Pet., at 15. On the contrary, the court properly recognized that the transfer giving rise to the asserted tax liability was the transfer of property *to*, not *from*, Howell. A sales tax would have been applicable to that transfer had Howell not improperly certified to his suppliers that he was purchasing the property for resale.

(1981); *United States v. Ortiz*, 422 U.S. 891, 898 (1975); *Adickes v. Kress & Co.*, 398 U.S. 144, 147, n. 2 (1970). As detailed immediately above, the question which Howell has framed for this Court's consideration first saw the light of day in his Petition for Rehearing by the Ninth Circuit. The question was not argued in the Court of Appeals, and consequently was not considered by it. Nor did Howell raise the present question in either the Bankruptcy Court or the District Court.

In an attempt to avoid this difficulty with his petition for review, Howell implies that he has consistently argued that the asserted tax is a "direct tax" against the United States. See Pet., at 12-13. As the Court of Appeals observed, however, while Howell made reference to such an issue in his pretrial statement, he did not argue the point in either the Bankruptcy Court or the District Court. 731 F. 2d, at 626, n. 1. Furthermore, even in the Court of Appeals, he argued a different theory than he does now. There he contended that the asserted tax was a "direct tax" on the United States not because the property was owned by the United States at the time of its use by Howell, but because the tax was levied on a "sale" of the property to the United States, with the incidence of the tax falling upon the United States as purchaser.

Surely, a litigant's use of "buzz words," such as Howell's on-again-off-again references to a "direct tax," does not give him the license to freely change his legal theories from one court to another and to seek "review" of questions that have not been previously considered and ruled upon. That was the clear indication of this Court in the *Searle* case, where the petitioner attempted to make a new due process argument in this Court after having made another due process argument in the courts below. The Court refused to address the new argument. See 102 S. Ct., at 1143, n. 7.

II

FAR FROM PRESENTING AN IMPORTANT QUESTION OF LAW, THE CASE DOES NOT EVEN RAISE THE ISSUE THAT HOWELL WANTS DECIDED.

In *United States v. New Mexico,* 455 U.S. 720 (1982), this Court ruled that a state's assessment of use taxes against a U.S. contractor was constitutionally permissible even though title to the property was held by the United States. Howell contends that it is important for this Court to go further and determine whether such an assessment is permissible when the United States is the owner of the property at the time of its use and the taxing state purports to levy only a "title-based use tax." That question, however, is not presented in the case at hand.

A. Title to the Property at Issue Here Did not Vest in the United States Prior to Its Use by Howell.

Howell's present claim that the taxes asserted by California constitute a direct tax on the United States is premised on his conclusion that title to the property vested in the United States prior to any use by him. In this regard, it is asserted in the petition for writ of certiorari that,

> ". . . the United States acquired title to the personal property installed by Howell at the *earliest* of two dates: (i) pursuant to the contractual provisions, when the Government made its initial progress payment, or (ii) by law, when Howell first attached the personal property to the Government's real property.
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> • • •
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> "Regardless of the precise time when title vested in the United States, one point remains clear: Title vested well before use by Howell." Pet., at 10-11 (emphasis in original).

As will be explained below, Howell made a taxable use of the property immediately upon its purchase because, though he purchased that property under resale certificates, it was never held by him for purposes of resale. Even

if the applicable statutory provisions could not be construed as reaching such an immediate use, by no stretch of the imagination can Howell's use of the property be regarded as occurring *after* his receipt of progress payments, or *after* he attached the property to realty belonging to the United States.

Section 6007.5 of the California Sales and Use Tax Law provides, in relevant part, that "A sale of tangible personal property to a contractor or subcontractor for use in the performance of contracts with the United States for the construction of improvements on or to real property in this State is a *retail sale*." (Emphasis added.) Howell chose to disregard this statutory provision and to purchase property from his suppliers under certificates stating that the property was being purchased for resale. Section 6094, subsection (a), of the California law provides that "If a purchaser who gives a resale certificate makes any use of the property other than retention, demonstration, or display while holding it for sale in the regular course of business, the use shall be taxable to the purchaser . . . as of the time the property is first used by him. . . ." See also § 6094.5.

It is unadulterated nonsense for Howell to contend that he made no taxable use of the property in question when he used it to improve real property belonging to the United States—the very use contemplated by section 6007.5. Evidently realizing that he is on shaky grounds, Howell resorts to a fall-back position: that, prior to any use by him, title to the property passed to the United States under the progress payment clause applicable to his contracts. This clause provided that "All material and work covered by progress payments shall thereupon become the sole property of the Government." Exhibit C to Stipulation of Facts, ¶ 15.[12] But it, too, creates problems for Howell. The clause

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[12]It is assumed, *arguendo*, that this clause was applicable to all of Howell's contracts. Actually, the stipulation referring to the progress payment clause pertained only to *three* of his contracts. See *supra*, at 10.

refers to "material *and* work" covered by progress payments and appears to contemplate that title to improvements will vest in the United States as construction proceeds. In any event, how can Howell logically argue that the clause precludes taxation of materials which have been used for construction purposes prior to receipt of a corresponding progress payment?

Howell attempts to solve the latter dilemma by audaciously inserting the word "initial" in his paraphrasing of the clause, asserting that title to the property passed to the United States "when the Government made its *initial* progress payment." Pet., at 10-11 (emphasis added); see also Pet., at 16 ("title passed [to the United States] at the time of the *initial* progress payment") (emphasis added); Pet., at 18 ("the use was that of the federal government in which title vested, either after the *initial* progress payment was made by the United States or after the first instant that Howell attached the personal property to the Government's realty") (emphasis added). Howell thus expects this Court to accept the proposition that once the "initial" progress payment was made, the United States became the owner of all materials to be used thereafter on the construction project. The payment clause itself provides otherwise.

Howell also talks about "the federal government's complete control over [his] activities, Pet., at 10,[13] and he asserts that this control, together with the progress payment

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[13]As previously pointed out, see *supra*, at 11, contractual provisions relating to the Government's control over Howell's activities were not the subject of a stipulation between the parties and the contract to which Howell refers (i.e., the contract for "Job 101") is not in evidence. Exhibit C to Stipulation of Facts, ¶ 15, which was agreed to contain the title clause included in three of Howell's contracts, also contains "boilerplate" provisions which appear to correspond to some of the provisions which Howell attributes to the contract for Job 101. There is at least one notable exception. Citing ¶ 9 of the Job 101 contract, Howell states that "before Howell could purchase personal property from its suppliers, the

clause, "clearly indicates that the United States regarded itself as the purchaser and owner of all personal property used by Howell." *Id.*, at 11. Several comments are in order. *First*, the contracts considered by this Court in *United States v. New Mexico, supra*, gave the Government control over all property purchased under the contracts, as well as over each contractor's property management procedures. 455 U.S., at 725. These facts were not considered indicative of an agency relationship between the United States and the contractors. *Second*, it has been the official policy of the Department of Defense since 1955 to *discourage* the use of agency provisions in its contracts.[14] See Defense Procurements Circular No. 76-8, pertinent excerpts of which are

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United States had to give Howell or Howell's prime contractor formal approval." Pet., at 11. This characterization of paragraph ¶ 9 of the contract does not jibe with the same numbered paragraph in Exhibit C, which reads, in relevant part:

"When required by this contract or when called for by the Contracting Officer, the Contractor shall furnish the Contracting Officer for approval full information concerning the material or articles which he contemplates incorporating in the work. When so directed, samples shall be submitted for approval at the Contractor's expense, with all shipping charges prepayed. Machinery, equipment, material, and articles installed or used without required approval shall be at the risk of subsequent rejection."

These provisions relate to quality control, and furthermore are operative only "when required by [the] contract or when called for by the Contracting Officer." It is unknown whether they pertained to the Job 101 contract or to any other contracts of Howell. Under such circumstances, if this Court were to grant the petition for review, and if the Board were expected to respond fully to Howell's contentions regarding the Government's control over his activities, presumably some mechanism would have to be provided for the introduction of additional evidence.

[14]The construction projects on which Howell performed electrical work included projects at Castle Air Force Base, Moffett Field, McClellan Air Force Base, Mare Island Naval Shipyard, and the U.S. Naval Air Station at Alameda, California. Stipulation of Facts. ¶ 4.

contained in the Appendix. It would thus seem strange to interpret the provisions discussed by Howell as being intended to create an agency relationship by implication. *Third,* if Howell is correct in asserting that the United States regards itself as the purchaser and owner of property that is subject to such contract provisions, it is remarkable that the California use tax has been applied to United States contractors without complaint by the Federal Government for nearly half a century. By contrast, the Federal Government sought injunctive relief against the legislation considered in *Washington v. United States, supra,* shortly after it was enacted. 103 S. Ct., at 1347.

B. Howell Made a Taxable Use of the Property When He Acquired and Held It For Purposes Other Than Resale.

Howell concedes, as he must, that the sales to him of property to be used in improving real property belonging to the United States were sales at retail under California law. See, e.g., Pet., at 8 ("[Sections 6007.5 and 6384] tax the transaction between the supplier and the government contractor as a retail sale"). A sale at retail is defined as meaning "a sale for any purpose *other than resale* in the regular course of business in the form of tangible personal property." (Emphasis added.) Since Howell goes on to assert that "[he] had no purpose in purchasing personal property from suppliers other than the eventual resale of that property to the federal government," Pet., at 18, it is apparently his notion that the sales of construction supplies to him were not *only* sales at retail but *also* sales for resale. This is absurd on its face. Under the California law, a sale of tangible personal property is either a retail sale *or* a sale for resale; it cannot be both.

Following the same line of reasoning, Howell professes to be bewildered by the Board's tax assessment, stating that "Why the Board determined to ignore[section 6007.5] and

impose an illegal use tax on Howell is . . . a mystery." Pet., at 18. See also Pet., at 8 ("Here, the Board—for unknown reasons—has determined not to follow its own statutes and impose a sales tax on Howell's suppliers under section 6007.5"); Pet., at 15 ("Even the Board acknowledges that it did not follow California's own statutory scheme by levying a sales tax on Howell's suppliers").[15]

The solution to the "mystery" is not in the least bit complicated. A purchaser who executes a resale certificate makes the representation that he is purchasing the particular property for the purpose of reselling it in the regular course of his business, and he thereby escapes reimbursing the seller for sales tax at the time of purchase. Thus, a resale certificate is properly used only when the purchaser knows at the time of purchase that the property will be resold in the regular course of business or does not know at that time whether the property will be resold or used. See *McConville v. State Bd. of Equalization, supra,* 142 Cal. App.2d, at 766. Where, on the other hand, a purchaser intends to use the property rather than resell it, the sale to him is a retail sale, *Standard Oil v. State Bd. of Equalization,* 232 Cal.App.2d 91, 95, 91 Cal.Rptr. 543 (1965), and the issuance of a resale certificate is improper. Under the latter circumstances, *any* exercise of dominion over the property will give rise to an immediate tax liability since the property is not held for resale in the regular course of business. Cal.Rev. & Tax Code §§ 6094, 6094.5.

Howell misinterprets these provisions of the California law when he claims that his use of the property was not

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[15]Howell also says that "the Board could have taxed Howell's suppliers under section 6007.5 regardless of Howell's issuance of resale certificates." Pet., at 18. This claim is contradicated by his own admission that "a purchaser can relieve the seller from liability for sales tax by giving the seller a resale certificate indicating that the personal property is to be resold by the purchaser." Pet., at 7. That is precisely the type of certificate which Howell gave to his suppliers in the case at hand.

"incident to ownership." Sections 6007.5 and 6384 specifically define as a taxable event the purchase by a contractor of property to be used in improving realty belonging to the United States. When such property is improperly acquired under a resale certificate, and the contractor exercises any dominion over it (including mere "storage" as defined in section 6008), he is making a use of that property incident to his ownership. Furthermore, section 6094.5, subsection (b), specifically provides that "[a]ny person who gives a resale certificate for property which he knows at the time of purchase is not to be resold by him in the regular course of business is liable to the state for the amount of tax that would be due if he had not given such resale certificate."[16]

It is further asserted that the California taxing scheme "all but compels Howell to collect the [use] tax from the owner of [the] property, the United States." Pet., at 18. The concept that Howell is talking about here comes into play when the United States is a party to the taxed transaction. See *Diamond National v. State Equalization Bd., supra,* 430 U.S. 551. In the present case, the State of California has not taxed the transaction between Howell and the United States, but rather has imposed a use tax against Howell based on his transactions with third parties.

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[16]Use taxes imposed on United States contractors on the basis of this absolute liability with respect to purchases at retail are substantially equivalent to the use taxes unanimously upheld by this Court in *United States v. New Mexico, supra.* It is also to be noted that the distinction drawn by Howell between a "possessory use tax" and a "title-based use tax" is reminiscent of the effort of the United States in *New Mexico* to distinguish between the "privilege type use tax" involved in *United States v. Boyd,* 378 U.S. 39 (1964) and the "compensating use tax" imposed by New Mexico. 455 U.S. at 738-739, n. 12. This Court found that the two taxes had the same practical operation and effect, stating:

> "Both taxes in terms reach the *use* of property; both have the effect of serving as enforcement mechanisms for the state

III

THE ALLEGED CONFLICT IN CASE AUTHORITY IS NONEXISTENT.

Howell contends that review is warranted in this case because the decision of the Court of Appeals conflicts with another decision in the *same* circuit, *United States v. Nevada Tax Commission,* 291 F. Supp. 530 (D. Nev. 1968), aff'd 439 F. 2d 435 (9th Cir. 1971), as well as with the decision of the First Circuit in *Federal Reserve Bank v. Commissioner of Corporations and Taxation,* 520 F. 2d 221 (1st Cir. 1975). The contention is without merit.

In the *Nevada* case, a U.S. contractor (Recco) was assessed use taxes on tangible personal property that had been used in performing a contract for the Atomic Energy Commission. Recco was engaged "in rendering construction, maintenance and operation, health, medicine and safety, and architect-engineering services to the AEC in connection with its operation and maintenance of the [Nevada Test] Site." 291 F. Supp., at 532. The only supplier mentioned in the case was Cashman Equipment Co. In setting forth the facts, the District Court noted that,

> "None of the property which was purchased from Cashman was purchased or resold for use or used in constructing improvements on or to real property. . . ." *Id.*

Thus, while it is true that the State of Nevada has a statute similar to section 6384 of the California Revenue and Taxation Code, that statute was not in issue in the *Nevada* case. It was not even mentioned in the District Court opinion.

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sales tax. Both serve to ensure that either the sale or the use of all property in the hands of non-immune entities will be taxed, no matter where the property is purchased." *Id.* (emphasis in original).

In addition, the contract involved in the *Nevada* case specifically provided that title to property to be used in performing the contract "shall pass directly from the vendor to the Government." *Id.* Thus, Recco, unlike Howell, *never* held title to the property in question.

Similarly, in the *Federal Reserve Bank* case, "[t]he contract [with the federal instrumentality] provided that title to all . . . materials was to pass directly from the vendor to the Government and that the contractor, who was required to furnish all materials, was acting as the purchasing agent for the Government in making arrangements for delivery of these items." 520 F. 2d, at 224. While the contract in that case did involve improvements to real property, there is no indication in the opinion that the State of Massachusetts had any statutes comparable to those of California expressly dealing with construction contracts.

Howell has also cited three state cases. See Pet., at 19. In both *General Motors Corp. v. State Com'n of Rev. & Tax.*, 182 Kan. 237, 320 P. 2d 807 (1958), cert. den., 358 U.S. 875 (1968) and *Avco Manufacturing Corp. v. Connelly,* 145 Conn. 161, 140 A. 2d 479 (1958), it was determined that the contractors had never held title to the property. In *State Tax Commission v. Graybar Electric Co.,* 86 Ariz. 253, 344 P. 2d 1008 (1959), it was determined that certain equipment had either been purchased by the contractor as agent of the United States or for resale purposes. None of the cases appear to have involved improvements to real property or statutes comparable to sections 6007.5 and 6384.

Howell nevertheless insists that the decision of the Court of Appeals is inconsistent with previous case authority and will throw the construction industry into turmoil. He states:

> "[The decision] prevents government contractors from properly allocating construction costs. It adds hidden costs to the contractor's services and the Gov-

> ernment's contract price. It threatens the predictability of bidding for, entering into, and performing construction contracts for the United States." Pet., at 22.

This is a facetious claim in the context of the present case. In the first two quarters of the tax period involved, Howell had purchased his materials on a tax-paid basis, and was therefore aware of the potential tax liability. Reporter's Transcript, at 23. Moreover, since Howell conceded in the Bankruptcy Court that he was liable for use taxes on materials (as distinguished from "fixtures") which he had purchased on an ex-tax basis, see *supra* at 12, it seems likely that he took such taxes into account in setting his contract prices. If he did not take the potential taxes into account, this may at least partially explain why he was able to underbid his competitors and thereby receive the Government's business in the first place.

CONCLUSION

Howell has not offered any legitimate basis for a review by this Court. Accordingly, the petition for writ of certiorari should be denied.

October 8, 1984.

Respectfully submitted,

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(Appendices follow)

Appendix A

State of California

BOARD OF EQUALIZATION

SALES AND USE TAX REGULATIONS

Regulation 1521. CONSTRUCTION CONTRACTORS.

References: Sections 6006-6010, 6012, 6012.2, 6012.8, 6012.9, 6015, 6016.3, 6016.5, 6054.5, 6055, 6091-6095, 6203.5, 6241-6246, 6276, 6276.1, 6379, 6384, 6386, 6421, 6901.5, Revenue and Taxation Code.

TABLE OF SUBTITLES

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- (1) "Construction Contract"
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- (3) "United States Construction Contractor"
- (4) "Materials"
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(6) Exemption Certificates
(A) Resale Certificates
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Appendix A—Typical Items Regarded as Materials
Appendix B—Typical Items Regarded as Fixtures
Appendix C—Typical Items Regarded as Machinery and Equipment and Items Not Regarded as Machinery and Equipment

(a) DEFINITIONS

(1) CONSTRUCTION CONTRACT

(A) "Construction contract" means and includes a contract, whether on a lump sum, time and material, cost plus, or other basis, to:

1. Erect, construct, alter, or repair any building or other structure, project, development, or other improvement on or to real property, or

2. Erect, construct, alter, or repair any fixed works such as waterways and hydroelectric plants, steam and atomic electric generating plants, electrical transmission and distribution lines, telephone and telegraph lines, railroads, highways, airports, sewers and sewage disposal plants and systems, waterworks and water distribution systems, gas transmission and distribution systems, pipelines and other systems for the transmission of petroleum and other liquid or gaseous substances, refineries and chemical plants, or

3. Pave surfaces separately or in connection with any of the above works or projects, or

4. Furnish and install property becoming a part of a central heating, air-conditioning, or electrical system of a building or other structure, and furnish and install wires, ducts, pipes, vents, and other conduit imbedded in or securely affixed to the land or a structure thereon.

(B) "Construction contract" does not include:

1. A contract for the sale or for the sale and installation of tangible personal property such as machinery and equipment, or

2. The furnishing of tangible personal property under what is otherwise a construction contract if the person furnishing the property is not responsible under the construction contract for the final affixation or installation of the property furnished.

(2) CONSTRUCTION CONTRACTOR. "Construction contractor" means any person who for himself, in conjunction with, or by or through others, agrees to perform and does perform a construction contract. "Construction contractor" includes subcontractors and specialty contractors and those engaged in such building trades as carpentry, bricklaying, cement work, steel work, plastering, drywall installation, sheet metal work, roofing, tile and terrazzo work, electrical work, plumbing, heating, air-conditioning,

elevator installation and construction, painting, and persons installing floor coverings, including linoleum, floor tile, and wall-to-wall carpeting, by permanently affixing such coverings to a floor.

(3) UNITED STATES CONSTRUCTION CONTRACTOR. "United States construction contractor" means a construction contractor who for himself, in conjunction with, or by or through others, agrees to perform and does perform a construction contract for the United States Government.

(4) MATERIALS. "Materials" means and includes construction materials and components, and other tangible personal property incorporated into, attached to, or affixed to, real property by contractors in the performance of a construction contract and which, when combined with other tangible personal property, loses its identity to become an integral and inseparable part of the real property. A list of typical items regarded as materials is set forth in Appendix A.

(5) FIXTURES. "Fixtures" means and includes items which are accessory to a building or other structure and do not lose their identity as accessories when installed. A list of typical items regarded as fixtures is set forth in Appendix B.

(6) MACHINERY AND EQUIPMENT. "Machinery and equipment" means and includes property intended to be used in the production, manufacturing or processing of tangible personal property, the performance of services or for other purposes (e.g., research, testing, experimentation) not essential to the fixed works, building, or structure itself, but which property incidentally may, on account of its nature, be attached to the realty without losing its identity as a particular piece of machinery or equipment and, if attached, is readily removable without damage to the unit or to the realty. "Machinery and equipment" does not

include junction boxes, switches, conduit and wiring, or valves, pipes, and tubing incorporated into fixed works, buildings, or other structures, whether or not such items are used solely or partially in connection with the operation of machinery and equipment, nor does it include items of tangible personal property such as power shovels, cranes, trucks, and hand or power tools used to perform the construction contract. A list of typical items regarded as machinery and equipment together with a list of typical items not regarded as machinery and equipment is set forth in Appendix C.

(7) TIME AND MATERIAL CONTRACT. "Time and material contract" means a contract under which the contractor agrees to furnish and install materials or fixtures, or both, and which sets forth separately a charge for the materials or fixtures and a charge for their installation or fabrication.

(8) LUMP SUM CONTRACT. "Lump sum contract" means a contract under which the contractor for a stated lump sum agrees to furnish and install materials or fixtures, or both. A lump sum contract does not become a time and material contract when the amounts attributable to materials, fixtures, labor, or tax are separately stated in the invoice.

(b) APPLICATION OF TAX.

(1) UNITED STATES CONSTRUCTION CONTRACTORS.

(A) Materials and Fixtures. United States construction contractors are consumers of materials and fixtures which they furnish and install in the performance of contracts with the United States Government. Either the sales tax or the use tax applies with respect to sales of tangible personal property (including materials, fixtures, supplies, and equipment) to contractors for use in the performance of contracts with the United States for the construction of improve-

ments on or to real property in this state. The fact that the contract may provide principally for the manufacture or acquisition of tangible personal property is immaterial. The sales tax, but not the use tax, applies even though the contractor purchases the property as the agent of the United States.

(B) Machinery and Equipment. United States contractors are retailers of machinery and equipment furnished in connection with the performance of a construction contract with the United States Government. Tax does not apply to sales of machinery and equipment to United States contractors or subcontractors, provided title to the property passes to the United States before the contractor makes any use of it. Such sales are sales for resale, and the purchasing contractor may issue a resale certificate. A contractor who uses the machinery or equipment before title passes to the United States is the consumer of that machinery or equipment and either sales tax or use tax applies with respect to the sale to or the use by the contractor.

(2) CONSTRUCTION CONTRACTORS OTHER THAN UNITED STATES CONSTRUCTION CONTRACTORS

(A) Materials.

1. In General. Construction contractors are consumers of materials which they furnish and install in the performance of construction contracts. Either sales tax or use tax applies with respect to the sale of the materials to or the use of the materials by the construction contractor.

2. When Contractor is Seller. A construction contractor may contract to sell materials and also to install the materials sold. If the contract explicitly provides for the transfer of title to the materials prior to the time the materials are installed, and separately states the sale price of the materials, exclusive of the charge

for installation, the contractor will be deemed to be the retailer of the materials.

In the case of a time and material contract, if the contractor bills his customer an amount for "sales tax" computed upon his marked up billing for materials, it will be assumed, in the absence of convincing evidence to the contrary, that he is the retailer of the materials.

If the sale occurs in this state, the sales tax applies to the contractor's (retailer's) gross receipts from the sale of the materials. If the sale occurs prior to the time the property is brought into this state, the contractor's (retailer's) customer is the consumer and his use (unless otherwise exempt) is subject to use tax measured by the sales price. The contractor must collect the use tax and pay it to this state.

(B) Fixtures.

1. In General. Construction contractors are retailers of fixtures which they furnish and install in the performance of construction contracts and tax applies to their sales of the fixtures.

2. Measure of Tax.

a. In General. If the contract states the sale price at which the fixture is sold, tax applies to that price. If the contract does not state the sale price of the fixture, the sale price shall be deemed to be the cost price of the fixture to the contractor.

b. Determining Cost Price. If the contractor purchases the fixtures in a completed condition, the cost price is deemed to be the sale price of the fixture to him and shall include any manufacturer's excise tax or import duty imposed with respect to the fixture prior to its sale by the contractor.

If the contractor is the manufacturer of the fixture, the cost price is deemed to be the price at

which similar fixtures in similar quantities ready for installation are sold by him to other contractors.

If similar fixtures are not sold to other contractors ready for installation, then the cost price shall be deemed to be the amount stated in the price lists, bid sheets or other records of the contractor.

If the sale price cannot be established in the above manner and the fixture is manufactured by the contractor, the cost price shall be deemed to be the aggregate of the following:

(1) Cost of materials, including such items as freight-in and import duties,

(2) Direct labor, including fringe benefits and payroll taxes,

(3) Specific factory costs attributable to the fixture,

(4) Any manufacturer's excise tax,

(5) Prorata share of all overhead attributable to the manufacture of the fixture, and

(6) Reasonable profit from the manufacturing operations which, in the absence of evidence to the contrary, shall be deemed to be 5 percent of the sum of the preceding factors.

Jobsite fabrication labor and its prorated share of manufacturing overhead must be included in the sale price of the fixture. Jobsite fabrication labor includes assembly labor performed prior to attachment of a component or a fixture to a structure or other real property.

3. Exceptions—Leased Fixtures. In some instances the construction contractor may furnish and install a fixture for a person, other than the owner of the realty, who intends to lease the fixture in place as

tangible personal property as provided in Section 6016.3 of the Revenue and Taxation Code and pay tax measured by rental receipts.

In this case the construction contractor may take a resale certificate from the lessor at the time of the transaction and the sale to the lessor will be considered to be a sale for resale. The resale certificate should indicate that the fixture is purchased for resale by the purchaser as tangible personal property under Section 6016.3 of the Revenue and Taxation Code.

(C) Machinery and Equipment.

1. In General. Construction contractors are retailers of machinery and equipment even though the machinery and equipment is furnished in connection with a construction contract. Tax applies to the contractor's gross receipts from such sales.

2. Measure of Tax.

a. In General. Tax applies to the gross receipts from the sale of machinery and equipment furnished and installed by a construction contractor. If the contract calls only for the furnishing and installation of machinery and equipment, tax applies to the total contract price less those charges excludible from gross receipts under Section 6012 of the Revenue and Taxation Code.

b. Lump Sum Contracts—Determining Gross Receipts. If the contract is for a lump sum and includes the furnishing and installation of materials, fixtures, and machinery and equipment, the gross receipts from the sale of the machinery and equipment shall be the price at which similar quantities ready for installation are sold at retail delivered in the market area where the installation takes place.

If there is no such retail price for the machinery and equipment, then the gross receipts shall be determined from the contracts, price lists, bid sheets, or other records of the contractor.

If the gross receipts cannot be established in the above manner and the machinery and equipment is manufactured by the contractor, the gross receipts from the sale shall be the aggregate of the following:

(1) Cost of materials, including such items as freight-in and import duties,

(2) Direct labor, including fringe benefits and payroll taxes,

(3) Specific factory costs attributable to the machinery or equipment,

(4) Any manufacturer's excise tax,

(5) Prorata share of all overhead attributable to the machinery or equipment, including overhead attributable to manufacturing, selling, contracting, and administration, and

(6) Reasonable profit from the manufacture and sale of the machinery or equipment which, in the absence of evidence to the contrary, shall be deemed to be 5 percent of the sum of the preceding factors.

Jobsite fabrication labor and its prorated share of manufacturing overhead must be included in the sale price of the machinery or equipment. Jobsite fabrication labor includes assembly labor performed prior to attachment of a component or the machinery or equipment to a structure or other real property.

(D) Cost Plus A Fee Contracts. When a contractor enters into a construction contract for a cost plus a fee or time and materials plus a fee, whether the fee is a lump sum

or a percentage of costs, the fee is not included in the measure of tax. When the contractor is the manufacturer of the fixtures or machinery and equipment, the "cost price" of the fixtures and the gross receipts from the sale of the machinery and equipment shall be determined in accordance with (B) and (C) above.

(3) MISCELLANEOUS SALES BY CONTRACTORS. In addition to sales of fixtures and machinery and equipment, tax applies to all retail sales by contractors of tangible personal property, including parts, supplies, tools, construction equipment, buildings severed or to be severed by the contractor, and furniture, including furniture sold with a building, even though the building is sold "in place."

(4) PERMITS. Contractors engaged solely in performing construction contracts which do not involve the sale and installation of fixtures and who do not also engage in business as sellers or retailers are not required to hold seller's permits. However, if a contractor is a seller or retailer because he makes sales of fixtures, materials, or machinery and equipment, or other tangible personal property either in connection with or as part of a construction contract, or otherwise, he is required to hold a seller's permit.

(5) SUPPLIES AND TOOLS FOR SELF-USE. Contractors are the consumers of supplies such as oxygen, acetylene, gasoline, acid, thread-cutting oil, and tools and parts for tools, which they use in their business, and the tax applies to the sale of such supplies and tools to contractors.

(6) EXEMPTION CERTIFICATES.

(A) Resale Certificates. Contractors holding valid seller's permits may purchase fixtures and machinery and equipment for resale by issuing resale certificates to their

suppliers. They may not purchase materials for resale unless they are also in the business of selling materials.

A contractor cannot avoid liability for sales or use tax on materials or fixtures furnished and installed by him by taking a resale certificate from the prime contractor, interior decorators, designers, department stores, or others. However, under the circumstances described in subsection (b)(2)(B)3., a contractor may take a resale certificate for fixtures furnished and installed by him for a person other than the owner of the realty.

(B) Exemption Certificates for Out-of-State Use. Sales tax does not apply to sales of tangible personal property to a construction contractor who holds a valid California seller's permit when the property is used by the contractor outside this state in his performance of a contract to improve real property and as a result of such use the property is incorporated into and becomes a part of real property located outside this state. This exemption is available only if at the time of the purchase the contractor certifies in writing to the seller that he holds a valid California seller's permit (giving the number of that permit and identifying the property purchased) and states that the property will be used in the manner stated above. The certificate must be signed by the contractor or an authorized employee. Such a certification may appear in the body of a purchase order which bears the signature of the purchaser. Any certificate given subsequent to the time of purchase will not be recognized.

If the property purchased under a certificate is used by the contractor in any other manner or for any other purpose than stated in the certificate, the contractor shall be liable for sales tax as if he were a retailer making a retail sale of the property at the time of such use, and the sale price of the property to him shall be deemed the gross receipts from the sale.

(C) Deductions for Tax-Paid Purchases Resold. A contractor may claim a "tax-paid purchases resold" deduction for any property of which he is the retailer when he has reimbursed his vendor for tax which the vendor is required to pay to the State or has paid the use tax with respect to the property, and has resold the property prior to making any use of it. In the event that the contractor sells short ends or pieces which are not used other than in severing them from larger units purchased by him and as to which he has paid sales tax reimbursement or use tax, he may claim the deduction for tax-paid purchases resold, but the amount of the deduction shall not exceed the price at which he sells such short ends or pieces.

(c) PARTICULAR APPLICATIONS.

(1) DRAPERIES AND DRAPERY HARDWARE. Persons who contract to sell and install draperies including drapery hardware, such as brackets, rods, tracks, etc., are retailers of the items which they furnish and install. Tax applies to the entire contract price exclusive of the charge for installation which charge should be separately stated. Installers who furnish drapery hardware or other tangible personal property may accept resale certificates from department stores or other sellers to furnish and install the draperies and drapery hardware.

The department stores or other sellers furnishing resale certificates are required to pay the tax to the state upon their selling price of the draperies and drapery hardware, exclusive of installation charges. The installer should segregate his installation charge in order that the department store or other seller may properly segregate its charge attributable to installation for purposes of determining its taxable gross receipts.

(2) PREFABRICATED CABINETS. A cabinet will be considered to be "prefabricated" and a "fixture" when 90

percent of the total direct cost of labor and material in fabricating and installing the cabinet is incurred prior to affixation to the realty. In determining this 90 percent, the total direct cost of all labor and materials in fabricating the cabinet to the point of installation will be compared to the total direct cost of all labor and materials in completely fabricating and installing the cabinet. If more than one cabinet is fabricated and installed under the contract, each cabinet will be considered separately in determining whether the cabinet is prefabricated.

(3) PREFABRICATED BUILDINGS. Prefabricated units such as commercial coaches, house trailers, etc., registered with the Department of Motor Vehicles or the Department of Housing and Community Development, are tangible personal property even though they may be connected to plumbing and utilities. A mobilehome which meets or is modified to meet, all applicable building codes and regulations and which is permanently affixed to realty, is an improvement to realty and is not personal property. Generally portable buildings which merely rest on redwood sills, piers or like property and are attached to realty only through plumbing and utility hookups are personal property.

Prefabricated and modular buildings, other than the type described above, affixed to the realty in a manner indicating that they are intended to remain permanently or indefinitely in place are improvements to realty for the purposes of this regulation. It is immaterial whether the buildings are erected upon or affixed to land owned by the owner of the building or are leased to the landowner or lessee of the land.

Prefabricated or modular buildings which are "factory-built housing" where permanently affixed to the realty are improvements to realty. The manufacturer of factory-built

housing who contracts to furnish and install the factory-built housing manufactured by him is the consumer of the materials used in building and installing the factory-built housing and the retailer of the fixtures. Tax applies as provided in (b) above.

(4) MOBILEHOMES INSTALLED FOR OCCUPANCY AS RESIDENCES. Operative July 1, 1980, a special measure of sales or use tax is provided for a mobilehome sold to be affixed to realty for occupancy as a residence.

A mobilehome dealer who sells a new mobilehome to a construction contractor to be affixed to land for occupancy as a residence is the "retailer-consumer" of the property and is required to pay tax for the period in which the sale was made by the dealer measured by an amount equal to 75 percent of the retailer-consumer's purchase price of the mobilehome.

A construction contractor who withdraws a new mobilehome from an inventory purchased for resale to be affixed to realty for occupancy as a residence in the performance of a construction contract is required to pay tax measured by 75 percent of the purchase price by his mobilehome vendor except where the purchase is made directly from a mobilehome manufacturer. In the absence of satisfactory evidence of the vendor's purchase price it shall be presumed that the measure of tax for the transaction is an amount equivalent to 60 percent of the sales price of the mobilehome to the construction contractor.

A mobilehome manufacturer who sells a new mobilehome directly to a construction contractor for installation to real property for occupancy as a residence is required to pay

tax measured by 75 percent of the sales price at which a similar mobilehome ready for installation would be sold by the manufacturer to a retailer-consumer in this state. A construction contractor who withdraws a new mobilehome from an inventory purchased from a manufacturer for resale must pay tax measured by 75 percent of his purchase price.

A mobilehome manufacturer who performs a construction contract by permanently affixing a new mobilehome to real property is the consumer of the material and the retailer of fixtures installed by him and the tax applies as set forth in paragraph (b) above.

Reference should also be made to the provisions of Regulation 1610 for additional interpretative rules relating to custom additions to the mobilehome prior to sale; transfers of nonvehicle items, and the application of the tax to a purchase made from an out-of-state retailer.

(5) REPAIR CONTRACTS. Contracts to repair fixtures are contracts for the sale and installation of parts when the sale price of the parts is billed separately from the repair labor. Tax applies to the sale price of the parts.

A contractor who enters into a lump sum contract to repair a fixture in place or a fixture he is required by the contract to reaffix to the realty is the consumer of the parts used.

(6) ELEVATOR INSTALLATIONS. A large number of components are included in the installation of an elevator system. Those portions constituting the cage or platform and its hoisting machinery are fixtures. The balance of the installation, if attached to a structure or other real property will generally be "materials."

Similarly, installation of escalators and moving sidewalks are in part fixtures and in part materials.

Following are examples of components constituting part of the cage platform and its hoisting machinery, and which are fixtures:

alarm bell
cab or car
car doors
car platform and sling
door hanger on cab
door openers
door operator on cab or car
door safety edge on cab
door sills on cab
electronic door protector
jack assembly
motors
power units and control boxes
pumps
pushbuttons on cab
wire and piping (which are components of a fixture)

Following are examples of components constituting "materials" when attached to realty:

car guides
casing section of jack assembly
guide rails
hoistway doors
hoistway door frames
hoistway door safety edge
hoistway door sills and jams
hoistway door supports
hoistway entrance
pushbuttons on hoistway
rail brackets
sill, struts
sound insulating panels on "materials"
structural steel (unless part of cab, car, or other "fixture")
valve strainer
wire and piping attached to "materials"

Following are examples of components constituting parts of escalators or moving sidewalks which are fixtures:

staircase
moving sidewalk
moving handrails
chains
sprockets
motors
other operating mechanisms

(7) DEEP-WELL AGRICULTURAL PUMPS. A deep-well agricultural pump is tangible personal property if installed so that it rests in position by force of gravity and is not otherwise affixed to the land.

The pump is a fixture if:

(A) It is affixed to the land such as by concrete, bolts or screws,

(B) It is physically connected to an irrigation system such as by pipes or couplings so as to become an integral part of the system, or

(C) It is enclosed by a pump house or other building or structure.

(8) REMOTE CONTROL GARAGE DOOR OPENERS. Remote control garage door opening units are fixtures. Portable transmitter units furnished pursuant to a construction contract are deemed to be fixtures and are taxable as provided in subdivision (b)(2)(B). Sales of portable transmitter units not a part of a construction contract, as, for example, sales of replacement units, are retail sales of tangible personal property and subject to tax as such.

(9) EXCESS REIMBURSEMENT. The excess tax reimbursement provisions of Regulation 1700 apply to construction contractors.

Appendix A The following is a list of typical items regarded as materials:

Asphalt
Bricks
Builders' hardware
Caulking Material
Cement
Conduit
Doors
Ducts
Electric wiring and connections
Flooring
Glass
Gravel
Insulation
Lath
Lead
Lime
Linoleum
Lumber
Macadam
Millwork
Mortar
Oil
Paint
Paper
Piping, valves, and pipe fittings
Plaster
Power poles, towers, and lines
Putty
Reinforcing mesh
Roofing
Sand
Sheetmetal
Steel
Stone
Stucco
Tile
Wall coping
Wallboard
Wallpaper
Wall-to-wall carpeting (when affixed to the floor)
Weather stripping
Windows
Window screens
Wire netting and screen
Wood preserver

Appendix B The following is a list of typical items regarded as fixtures:

Air conditioning units
Awnings
Burglar alarm and fire alarm fixtures
Cabinets, counters, and lockers (prefabricated)
Electric generators (affixed to and accessory to a building, structure or fixed works)
Elevators, hoists, and conveying units
Furnaces, boilers and heating units
Lighting fixtures
Plumbing fixtures
Refrigeration units
Signs
Telephone switchboards and instruments
Television antennas
Transformers and switchgear
Vault doors and equipment
Venetian blinds

Appendix C The following are lists of typical items regarded as:

Machinery and Equipment
Drill presses
Electric generators (unaffixed, or, if affixed, which meet the requirements of subparagraph (a)(6)
Lathes
Machine tools
Moving parts of cranes
Printing presses

Not Machinery or Equipment
Fixtures and materials as defined in this regulation
Wiring, piping, etc., used as a source of power, water, etc., for machinery and equipment
Radio transmission antennas
Large tanks (i.e., over 500 barrel capacity)
Fire alarm systems
Street light standards
Cooling towers other than small prefabricated cooling units

History: Effective July 1, 1939.

Adopted as of January 1, 1945, as a restatement of previous rulings.

Amended September 2, 1965, applicable as amended September 17, 1965.

Amended and renumbered November 3, 1971, effective December 3, 1971.

Amended February 4, 1976, effective April 1, 1976. Rewrote and expanded regulation for clarity, combined Regulation 1615, added particular applications, and applied Regulation 1521 definition of "fixture" to U.S. Contractors.

Amended August 17, 1976, effective September 19, 1976. Clarified "U.S. Government," limited exemption certificate, and clarified "generators" in appendices.

Amended December 7, 1978, effective February 18, 1979. Subsections (a)(3), (b)(1)(A), and (b)(1)(B) no longer reference instrumentalities of the United States; subsection (b)(1)(A) was amended to apply sales tax to the sale of tangible personal property to contractors for use on construction contracts with the United States; amends subsection (c)(7) to provide that the section only applies to transactions prior to 1/1/79.

Amended August 1, 1980, effective August 22, 1980, operative July 1, 1980. On first page, added (c)(4) and renumbered following subsections; in (c)(3), first sentence, deleted "mobile homes" and substituted "commercial coaches"; in third paragraph, deleted "as defined in Regulation 1521.2," from first sentence, and deleted second sentence; added (c)(4), and renumbered following sections.

Amended November 19, 1980, effective January 16, 1981. In (c)(3) corrected typographical error. In (c)(4), third paragraph, substituted "construction contractor"

for "any person,"; added "in the performance of a construction contract," and added exception for purchases made directly from a mobilehome manufacturer; substituted "construction contractor" for "person withdrawing and affixing the property to realty,". In fourth paragraph, added provision re withdrawal by construction contractor of new mobilehome from inventory purchased from a manufacturer.

Amended December 1, 1983, effective April 14, 1984. In (c)(3) added reference to the Department of Housing and Community Development. In (c) added new (c)(8) and renumbered former (c)(8) to (c)(9); deleted former text and added reference to Regulation 1700. Deleted former subdivision (d). In appendix C changed reference to subparagraph (a)(6).

Appendix B

DEFENSE PROCUREMENT CIRCULAR

15 June 1977 NUMBER 76-8

This Defense Procurement Circular is issued by direction of the Secretary of Defense pursuant to the authority contained in 5 U.S. Code 301, 10 U.S. Code 2202, DoD Directive No. 5126.22, and ASPR 1-106.

All Armed Services Procurement Regulation material and other directive material published herein is effective upon receipt except as otherwise indicated.

Unless otherwise indicated in the introductory language preceding an item, each item in this Circular shall remain in effect until the effective date of that subsequent ASPR revision which incorporates the item, or until specifically canceled.

Reproduction authorized.

SPECIAL NOTE: All replacement pages furnished with Defense Procurement Circulars *(whether or not identified by specific items)* are replacement pages for the 1976 Edition of ASPR.

ITEM X—GUIDANCE—STATE AND LOCAL SALES AND USE TAXES

The Office of Federal Procurement Policy recently expressed concern with assertions by the Department of Defense (DoD) and its contractors of immunity under the United States Constitution from state and local sales and use taxes on the basis that the contractors are agents of the United States in purchasing supplies for use in performance of their DoD contracts.

The DoD policy on this matter was first set forth in a 1955 letter to the Director of the Bureau of the Budget as follows: "It has been determined that it will be the policy of the Department of Defense not to designate prime contractors on cost-type contracts to be performed within the continental limits of the United States, as agents of the Government for the purchase of supplies." This policy was adopted shortly after the decision of the United States Supreme Court (*Kern-Limerick, Inc. v. Scurlock* 347 U.S. 110 (1954)) which was favorable to the United States and its contractor because the contract involved contained a clause which appeared to have as its purpose the avoidance of a state tax. The policy was adopted to preclude the inclusion in DoD contracts of clauses which were designed to avoid otherwise validly imposed state or local taxes. That policy is still in effect today.

While DoD policy not to include clauses in DoD contracts designating contractors as agents of the Government is clear, the question arises whether it is appropriate, in the absence of a contract clause expressly designating a contractor as an agent of the Government, for the Government to contend in a dispute with a state taxing authority that the contractor is in fact an agent of the Government for

the purpose of immunity from state and local sales and use taxes. In this regard, the Office of Federal Procurement Policy has advised that:

> ". . . existing legal precedents lend little support for the contention that a contractor is an agent on the basis of Government title and subcontract-review clauses or other arrangements short of contract provisions clearly intended to make the contractor an agent of the Government or authorizing him to pledge the credit of the Government or make purchases in its name or for its account."

While DoD has agreed in general with this expression of legal precedents, there could be circumstances where it could be properly contended that the contractor is an agent of the Government for the purpose of immunity from a state and local sales and use taxes. Circumstances giving rise to such a situation would seemingly be rare. It is DoD intention to ensure that procurement activities do not contend that contractors are agents of the Government where circumstances surrounding the procurement do not clearly support the contention.

Before any DoD activity contends that any of its contractors are agents of the Government for the purpose of claiming immunity from state or local sales or use taxes, the matter will be referred to the Office of the Secretary of Defense (OSD), Assistant Secretary of Defense (MRA&L) for review to ensure that they are in conformance with DoD policies and the contention is fully in accord with the pertinent legal principles and precedents. Each case forwarded will be reviewed at the Secretarial level in the Military Departments and the Director level in the Defense agencies before referral to OSD. The referral will include all pertinent data on which such a contention would be based, together with a thorough analysis of all relevant legal precedents.

Whenever clauses, procedures and business practices are cited by DoD activities to support the contention that a contractor is an agent of the Government for the purpose of immunity from a state or local sales or use tax, it is our intention whenever possible to devise alternative clauses, procedures and practices for future use which will accomplish their intended purpose without providing the basis for the contention that the contractor is an agent of the Government for the purpose of immunity from state or local sales or use taxes. Therefore, any referral to OSD will include comment on the extent to which alternate clauses, procedures or practices may be utilized to accomplish the intended purpose without providing the basis for the contention that the contractor is an agent of the Government for the purpose of immunity from state and local sales and use taxes.

There are, and will remain, bases for challenging the application of state taxes to transactions by DoD contractors which do not depend upon the contention that the contractor is immune on constitutional grounds because of the existence of an agency relationship between the Government and the contractor. Claims for exemption from state or local sales or use taxes, which are not based on that contention will not be submitted to OSD for review.

Office-Supreme Court, U.S.
FILED
OCT 19 1984
ALEXANDER L. STEVAS,
CLERK

No. 84-353

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

IN RE EDWARD W.W. HOWELL,
d/b/a HOWELL ELECTRIC COMPANY,
Debtor.

EDWARD W.W. HOWELL,
d/b/a HOWELL ELECTRIC COMPANY,
Petitioner,

v.

THE STATE BOARD OF EQUALIZATION,
Respondent.

On A Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

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REPLY BRIEF FOR PETITIONER EDWARD W.W. HOWELL, d/b/a/ HOWELL ELECTRIC COMPANY

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October 19, 1984

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§ 6007.5 6

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REPLY BRIEF FOR PETITIONER EDWARD W.W. HOWELL, d/b/a/ HOWELL ELECTRIC COMPANY

In its Brief in Opposition, the California State Board of Equalization ("the Board") resorts to baseless charges in its attempt to stave off review by this Court. It complains that the legal question presented by petitioner Edward W.W. Howell, d/b/a Howell Electric Company ("Howell") "was not argued

or considered in the courts below." Br. Opp. at 3.[1] It alleges that "[t]he petition for review by this Court reflects a lack of respect for the appellate process." *Id.* It argues that Howell has "misrepresented applicable California law . . . [and] altered the record to suit his purpose." *Id.* These contentions are utterly without merit. While such rhetorical hyperbole does nothing to promote the proper resolution of this case, it is nonetheless telling that the Board virtually ignores the substance of the Ninth Circuit's opinion, and has chosen to shield the illogic of its interpretation—and application—of the California use tax behind the wholly-erroneous contention that Howell *never* raised this question below.

In light of the heat of the Brief in Opposition, it is important at the outset to understand why the Board has gone to such great lengths to avoid discussing the question presented by Howell: Whether California, by purporting to levy a use tax on Howell, is really taxing the United States. At the heart of this question is the important legal distinction between a title-based and a possessory use tax. *See, e.g.,* Howell Pet. at 5-6, 18. Since California's use tax is a title-based tax, that State can impose the tax *only* when use of personal property is incident to legal ownership of that property. *Id.* at 9-10. Accordingly, if California taxes property owned by the United States, that tax violates the Government's constitutional immunity from state taxation.

As will be demonstrated below, and despite the Board's assertions to the contrary, the record clearly indicates that the Board taxed Howell for its "use" of Government-owned property. The Board's facile attempt to downplay the importance of the legal distinction between a title-based and possessory use tax—its entire discussion of this matter is relegated to a single footnote [2]—is tacit recognition by the Board that it has no

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[1] *See also* Br. Opp. at 16 ("Howell contends that . . . the United States is the owner of the property at the time of its use and the taxing state purports to levy only a 'title-based use tax.' That question, however, is not presented in the case at hand.").

[2] *See* Br. Opp. at 22-23 n.16. In that footnote, the Board misleadingly implies that this Court, in the cases of United States v. New Mexico, 455 U.S.

(footnote continues)

authority under the California Revenue and Taxation Code to impose a use tax against Howell in this context. Under the relevant legal precedents,[3] the Board's application of the California use tax is unconstitutional since it falls squarely on the owner of the personal property at issue, the United States. It is this impermissible application, and the court of appeals' failure to take into account the precise nature of the tax being imposed, that makes this case particularly worthy of review by the Court.

1. Contrary To The Board's Allegation, The Question Presented Here Was Raised And Argued By Howell In The Court Proceedings Below.

The Board seeks to prevent this Court from reviewing the circuit court's opinion. It argues that Howell did not raise the question presented until its Petition For Rehearing by the Ninth Circuit. *See* Br. Opp. at 3-4, 14-15. This strained contention is totally inaccurate and can be quickly dismissed.

To repeat, Howell is asking this Court to review whether the Board's application of the California use tax to personal property owned by the United States is a direct tax on the Government. *See* Howell Pet. at i, 13-15. As the Board is well aware, this issue was raised by Howell at the beginning of this proceeding. Indeed, it was incorporated in paragraph 15 of the Stipulation Of Facts filed with the Bankruptcy Court, Northern District of California, on August 20, 1980.[4] We are frankly bewildered by the Board's argument in this regard since the Board itself quotes this paragraph in its Brief in Opposition. *See* Br. Opp. at 10.

(footnote continued)

720 (1982), and United States v. Boyd, 378 U.S. 39 (1964), attached no significance to the distinction between a title-based and a possessory use tax when deciding a question of federal immunity from taxation. This charactization is inaccurate. Both of these cases concerned a posessory, not a title-based use tax. *See* United States v. Boyd, 378 U.S. at 40.

[3] *See* Howell Pet. at 17-19.

[4] As the Ninth Circuit specifically noted in its opinion, the general issue of whether the Board has impermissibly levied a direct tax on the United States was also raised by Howell in its pretrial statement before the Bankruptcy Court. *See* Pet. App. A, p. 3a n.1.

Paragraph 15 of the Stipulation Of Facts provides in relevant part that:

> The parties agree that certain materials purchased by Howell and in inventory at the site of construction were not installed by Howell but passed from Howell's control to the prime contractor prior to installation pursuant to the terms of the respective prime or subcontracts. . . . Howell contends that the transfer of the inventory from Howell's control to the prime contractor was a sale for resale to the United States Government or, in the alternative, *that the Board improperly taxed the material because title thereto was transferred to the United States Government prior to any use by Howell. A copy of the typical title clause included in said prime or subcontracts is attached hereto as Exhibit C.*

Stipulation Of Facts at ¶ 15 (filed with the United States Bankruptcy Court, Northern District of California, August 20, 1980) (emphasis added).

The Board's curious assertion that the legal question presented for this Court's consideration was not argued to the Ninth Circuit is equally unavailing and patently erroneous.[5] Thus, in its reply brief to the court of appeals, Howell specifically pointed out that, under California law, there is no authority for the Board to impose a use tax on federal contractors for their use of Government-owned property. Reply Brief for Appellant at 10-11, *Howell* v. *State Board of Equalization (In re Howell)*, 731 F.2d 624 (9th Cir. 1984).

Moreover, in its papers before the Ninth Circuit—as here—Howell relied on the fundamental distinction between a title-based and a possessory use tax to demonstrate that the Board's levy of California's title-based use tax in these circumstances is unconstitutional. *Id.* The Board acknowledges only that Howell raised this question in its Petition for Rehearing before the Ninth Circuit. *See* Br. Opp. at 15.

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[5] It should be noted that the Board made virtually the same argument to the Ninth Circuit. That court properly rejected the Board's attempt to forestall Howell's right of appellate review. *See* Pet. App. A, pp. 3a-4a.

As detailed in Howell's petition, the circuit court, although confronted with the Board's impermissible application of California's use tax, completely misinterpreted the nature of the precise transaction being taxed. Howell Pet. at 13, 15. It apparently assumed that a sales tax, not a use tax, was being imposed. *Id.* In its Brief in Opposition, the Board seems to be arguing that, because the Ninth Circuit did not properly address this question, the issue is not susceptible to this Court's review. The Board, however, is confusing the issue of whether Howell raised this legal question with the entirely separate issue of whether the Ninth Circuit properly considered Howell's contention. There is not the slightest merit to this attempt to circumscribe the traditional scope of appellate review. The question presented is appropriately before this Court.

2. Pursuant To The California Revenue And Taxation Code, As Well As Under Well-Established Case Law Principles, It Is Clear That Howell Was Improperly Assessed A Use Tax On Property Owned By The United States.

In its effort to evade this Court's review, the Board also argues that Howell made taxable use of personal property *before* legal title passed to the United States. *See* Br. Opp. at 16-22. The Board—while incorrectly accusing Howell of raising a new question before this Court—contends for the first time in this proceeding that "[a] sales tax would have been applicable to that transfer [of property to Howell from its suppliers] had Howell not improperly certified to his suppliers that he was purchasing the property for resale." Br. Opp. at 14 n.11, 22. In this connection, the Board also alleges that Howell did not purchase the property for resale because it made taxable use of the property before legal title passed to the United States. The Board's novel, and inconsistent, assertions are governed by a series of unsupported and misdirected legal arguments. They are all without merit and should be rejected.

As noted directly above, the Board's contention that Howell improperly used resale certificates was never raised below. It is thus not properly before this Court. Moreover, the Board's own actions belie its belated argument. If the Board

believed that Howell did not have the authority to issue resale certificates, it should have imposed a sales tax on Howell's suppliers under section 6007.5 of the California Revenue and Taxation Code. The record of the proceedings below, as well as the Board's own admissions before this Court, indicate, however, that the Board imposed a use tax on Howell, not a sales tax on Howell's suppliers. *See* Howell Pet. at 8 & n.7. *See also* Br. Opp. at 9.

The Board's second argument, that Howell did not purchase the property for resale because it "used" that property before title passed to the Government, borders on the absurd. As detailed in its petition, Howell is an electrical contractor. It purchased electrical equipment—e.g., electrical switchgear, transformers, and generators [6]—for the sole purpose of attaching that equipment to the Government's real property. *See* Howell Pet. at 10-11.

Moreover, as to three of the contracts, Howell did not even install the electrical equipment purchased from its suppliers. It merely resold that personal property to a prime contractor. *See* Stipulation Of Facts at ¶ 15. In short, Howell had no purpose in purchasing electrical equipment from suppliers other than to resell it to the United States "in the regular course of business." CAL. REV. & TAX. CODE § 6007 (Deering 1975).

Despite this evidence, the Board argues that Howell somehow "used" the property before title passed to the United States. And it insists that such use precludes Howell from claiming either that the tax transactions are sales for resale or that they are exempt from California's use tax. There are several serious flaws in these arguments.

First, the Board totally fails to recognize that, under the current California tax scheme, a federal contractor can be exempt from both the sales and use tax if title passes to the United States before taxable use.

Second, the Board seeks to construe as "use" a federal contractor's transient possession of the property before the ultimate owner, the United States, acquires legal title. The issue in each proceeding is whether such temporary ownership is

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[6] *See* Stipulation Of Facts at ¶ 18.

taxable use. Here, it is not. This is because there must be *both* ownership and use at the same time before a use tax can be imposed in California. Here there is possession by Howell, but ownership by the United States at the time of use.

It stretches the California use tax well beyond its intended limits to argue that Howell "used" electrical equipment before attaching it to the Government's realty. As noted in Howell's petition, title passed the moment the equipment was attached to the Government's real property, or when the Government made its initial progress payment. Howell Pet. at 10, 11 & n.9, 16. Significantly, the Board in its Brief in Opposition does not, and cannot, challenge the well-settled proposition of California law that, at the precise moment personalty is affixed to realty, title passes. *Id.*

The Board's only response is to suggest that Howell is "bucking history" by challenging the Board's application of the California use tax law. It argues, in effect, that if the United States has not challenged their interpretation, it must be right. *See* Br. Opp. at 20. This is utter nonsense.

The issue of whether the Board can impose a use tax under circumstances similar to those presented here was decided in the case of *Lockheed Aircraft Corp.* v. *State Board of Equalization,* 81 Cal. App.3d 257, 146 Cal. Rptr. 283 (1978). In that action, federal-contractor taxpayers acquired or constructed special test equipment in the performance of several defense contracts. The Government contracts provided that title would pass to the Government "[w]hen any progress payment is made under" the contracts. 146 Cal. Rptr. at 286-87 n.4. The federal contractors clearly made *some* use of this equipment before progress payments were paid and title passed to the Government. The contractors actually built the special equipment that was taxed. The California court, however, rejected the Board's theory that taxable use occurred. It reasoned that use of the property "was limited to the performance of the contract." *Id.* at 287. Under these factual circumstances, the court held, the use tax could not be imposed. *Id.* at 292-93.

That reasoning applies here with even greater force. The only use Howell made of the personal property was to install or attach electrical equipment to the Government's realty. And, as pointed out above, Howell did not itself even install some of that equipment: Under three of the Government contracts, Howell merely transferred the property to another federal contractor. *See* Stipulation Of Facts at ¶ 15. The Board's claim that this constituted a taxable use of the property is inconsistent with California law and the reality of the contracts at issue. It should not be taken seriously.

3. The Board Has Failed To Explain Why The Result In This Case Should Be Different From Other Federal Decisions On The Same Issue.

The Board bobs and weaves in an effort to distinguish two federal cases that are in direct conflict with the Ninth Circuit's decision in this proceeding: *United States* v. *Nevada Tax Commission,* 291 F. Supp. 530 (D. Nev. 1968), *aff'd,* 439 F.2d 435 (9th Cir. 1971), and *Federal Reserve Bank* v. *Commissioner of Corporations and Taxation,* 520 F.2d 221 (1st Cir. 1975).

With respect to the *Nevada* case, the Board contends that the Nevada equivalent of California section 6384 was not at issue. Br. Opp. at 23. It also argues that in *Nevada,* unlike this action, the federal contractor never held title to the property in question. *Id.* at 24. These contentions are simply incorrect.

The Board's first argument is based on a patently-strained reading of the *Nevada* case. Before the circuit court, the Board claimed that the Nevada taxation scheme was different from California's. Brief for Appellee at 11-12, *Howell* v. *State Board of Equalization (In re Howell),* 731 F.2d 624 (9th Cir. 1984). Now, it admits "that the State of Nevada has a statute similar to section 6384 of the California Revenue and Taxation Code, . . ." Br. Opp. at 23. While the Nevada equivalent of section 6384 was not specifically mentioned in the *Nevada* opinion, it is obvious that this provision of the Nevada Tax Code was involved since the transaction in question concerned a sale of personal property from a supplier to a government

contractor. *Id.* Section 6384, and its Nevada counterpart, are the only statutory provisions that would cover such a tax transaction.

The Board's second argument, that this case is different because the federal contractor in *Nevada* used the property *after* title passed to the Government, is equally erroneous. As detailed above, Howell, like the federal contractor in *Nevada,* did *not* have title to the personal property being taxed. Accordingly, the legal incidence of the use tax did not fall on Howell, but directly upon the owner of the personal property at issue, the United States.

As to the *Federal Reserve Bank* case, the Board continues to ignore the simple—but determinative—fact that Massachusetts, like California, can only impose a use tax on a federal contractor when use is "incident to the ownership of that property." *See* 520 F.2d at 226. Howell, like the federal contractors in the *Federal Reserve Bank* action, had possession, but not legal title to the personal property in question. Thus, Howell cannot be taxed without running afoul of the Government's immunity from state taxation. That is what happened here.

CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be granted.

Respectfully submitted,

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